Delta variant brings new uncertainty to global economic recovery

Investment Markets	BCT's Investment Views	Summary
Equities		
US		We are neutral on U.S. equities. The spending plans, coupled with continued vaccinations and reopenings, should support consumer spending in goods and services sectors. However, potential tax hikes and inflation resulting from supply shortages could act as a dampener.
Europe		We are neutral on European equities. Strong economic growth and accommodative policy support our view of a cyclical recovery. However, lots of the good news is priced into the markets and we prefer to be selective amid inflation pressures.
Japan		We are neutral on Japanese equities. Relative earnings trend suffered recently due to strong earnings in the U.S. and Europe. However, in the long term, global cyclical recovery and prospects of a weakening yen should be supportive for Japanese markets.
Asia ex Japan		We are positive on Asian equities. We believe the positive sentiment in markets has not been derailed. Any economic impact from renewed lockdowns will be better quantified and managed compared to last year.
China & HK		We remain positive on Chinese equities. Policy adjustment and slower deleveraging are expected ahead, which await to be confirmed at the end-July Politburo meeting. We are neutral on Hong Kong equities. Hong Kong's labour market recovered further, with the unemployment rate down to 6% in May. However, the timing of opening of borders is still unclear, it may affect Hong Kong's recovery pace.
Global Bonds		
Government Bonds		We are cautious on government bonds. Fundamental picture still supports higher levels of rates and a steeper curve. We remain positive on credit. The economic backdrop is strongly in favour of the trade as global reopening should maintain supportive fundamentals and risk sentiment is favourable.
Credit		

Scales of weighting			
	Underweight	Neutral	Overweight

U.S. EQUITIES

U.S. equities continued to gain, the S&P 500 continued the growth started in April last year, marking its fifth positive quarter in a row with a return of +8.5% in Q2 2021 and a gain of +2.3% in June. Confidence in recovery post-vaccinations and the positive earnings season helped drive the stock market higher. In addition, the tentative bipartisan agreement in the U.S. Senate on infrastructure plans and the successful passage of stress tests for banks in June contributed to the growth. The U.S. economy's rebound from the pandemic was driving the biggest surge in inflation in more than a decade with consumer prices rising in May to 5% year-on-year. Overall, macro data continued to be positive, indicating healthy expansion and signalling no overheating. In terms of monetary policy, the Federal Reserve (Fed) looked more open to start talking about reduction of asset purchase program. Officials signalled that they expected to raise interest rates at least twice by the end of 2023, as the economy recovers rapidly from pandemic and inflation heats up.

Thanks to an extremely accommodative policy mix, the U.S. economy will continue to recover strongly. While GDP most likely has already reached pre-pandemic levels, the labour market is recovering at a slower pace, which should pick up from Q3. While inflation is expected to peak in Q2 and then progressively decelerate, we have revised up inflation outlook for 2021-22 on signs of more persistent yet transitory in nature upside pressures. The Fed will most likely consider these developments in line with its goal and keep an accommodative policy stance. The Fed is preparing the ground for a normalisation of its quantitative easing (QE) policy. It should start talking about QE in August or September and start tapering asset purchases in early 2022. The language on inflation has shifted to more explicitly acknowledging upside risks. We are neutral on U.S. equities. The spending plans, coupled with continued vaccinations and reopenings, should support consumer spending in goods and services sectors. However, potential tax hikes and inflation resulting from supply shortages could act as a dampener. In this environment, we remain selective and look for companies that have the pricing power to pass on the increase in input prices to consumers to preserve margins.

EUROPEAN EQUITIES

The MSCI Europe was up +6.5% in local total return terms for Q2. In Europe, economic activities are gaining momentum benefiting from the ongoing lifting of COVID-19 restrictions, which have enabled economies to reopen progressively. Confidence in current and future economic activities continued to improve, with upticks in activities in sectors hardly hit by the pandemic providing further evidence of bottoming out. The vaccination rollout had an acceleration over Q2 and this is supporting a strong recovery in Europe. Eurozone inflation was 1.3% year-on-year at the end of March and it accelerated to 1.9% in June. Overall inflation readings confirmed an upward trend, which lost some momentum in June. From a monetary perspective, during the quarter, the European Central Bank (ECB)'s President Christine Lagarde reaffirmed the overall dovish tone confirming its pandemic emergency purchase programme. The ECB delivered accommodating statements with a stable outlook for quantitative easing and a mixed revisions to the economic outlook. The ECB economists' growth and inflation forecasts have been revised upwards, but inflation in 2023 is still unchanged and well below the central bank's 2% target.

After contracting in Q1 as a consequence of restrictions implemented in several countries, we expect moderate growth in Q2 followed by a stronger acceleration as restrictions will be broadly lifted, vaccination campaigns will progress, and consumer and business confidence will improve. Fiscal and monetary policy mix will remain accommodative, underpinning the recovery. Inflation should progress along an upward trend, mainly due to a transitory effect, overshooting in Q4 before reverting the trend in 2022. In June, the ECB confirmed its Pandemic Emergency Purchase Programme (PEPP) purchases at a significantly higher pace. As broadly pre-announced, there is no sign of tapering for now, and policy remains ultra-easy. Revisions to the economic outlook improved for 2021 and 2022. Monetary stimulus is expected to remain in place and, in this respect, the September meeting is likely to provide more guidance on stimulus deployment in Q4 2021 and in 2022. We are neutral on European equities. Strong economic growth and accommodative policy (ECB and Next Gen EU plan) support our view of a cyclical recovery. However, lots of the good news is priced into the markets and we prefer to be selective amid inflation pressures.

JAPANESE EQUITIES

The Japanese equity market posted positive return in June with the TOPIX advancing by +1.2%. Although the COVID-19 infection rate in Japan was still significantly lower than in most other countries, the continued increase in cases had caused the government to postpone the lifting of the state of emergency until late June. However, by the end of May, since bureaucratic and logistical problems seemed to have been overcome, the vaccination rate increased substantially. Japan is now able to vaccinate approximately one million doses per day. The corporate financial reporting season ended in May, and the data released by most companies met or slightly exceeded market expectations. In the past two quarterly earnings seasons, the number of companies that reported lower-than-expected earnings was significantly lower than normal. At the same time, Japan's June Purchasing Managers' Index (PMI) data beat expectations, indicating that the manufacturing and service industries continued to expand.

On 18 June, the Bank of Japan (BoJ) left major policies unchanged, and extended corporate financing support by another six months to March 2022. The support includes special financing program in response to COVID-19, with a current amount of 69 trillion yen. Governor Kuroda maintains a cautiously optimistic outlook, noting that the economy is improving and that inflation will eventually pick up after vaccinations reach a critical level. However, with current slow vaccinations, the BoJ is expected to stay behind the curve in 2021. After the first quarter GDP miss and the low vaccination rate, Japan is expected to grow at a relatively slower pace than the other developed markets in 2021. Herd immunity is likely to be achieved at the end of 2021, delaying consumption recovery to early 2022. Meanwhile, Japan will continue to benefit from resilient external demand, in particular machinery orders from China and capital goods orders from the U.S. Global capital expenditure cycle bodes well for Japanese corporate earnings growth. We are neutral on Japanese equities. Relative earnings trend suffered recently due to strong earnings in the U.S. and Europe. However, in the long term, global cyclical recovery and prospects of a weakening yen should be supportive for Japanese markets.

ASIA EX-JAPAN EQUITIES

Vaccination rates increased globally but remain imbalanced. Within emerging markets in Asia, vaccination progress continues to be asymmetric. Some countries saw an elevated number of Delta variant cases and imposed strict lockdown measures in response. Singapore Straits Times Index (STI) closed lower by -1.1% month-on-month during the period, driven by weakness in the Consumer Staples and Telecommunications sectors. In Indonesia, despite all the headwinds experienced by the market, the Jakarta Composite Index (JCI) remained resilient and closed slightly higher in June, up by +0.6%. In Thailand, the Stock Exchange of Thailand Index (SETI) closed lower by -0.4%. The country is currently defending against another wave of infections, with variants Delta and Beta becoming more rampant. This posed a threat to economic recovery, especially international tourism. In Malaysia, the Kuala Lumpur Composite Index (KLCI) closed lower 3.2% month-on-month in June as market sentiment was dented by rising COVID-19 cases, stricter movement control order, and heightened political turmoil.

In Singapore, we believe the market will recover due to the declining number of COVID-19 cases and a well-executed vaccination plan, which may lead to a possible easing of restrictions by end-July. In Indonesia, we expect the lingering concerns to continue to dictate market direction. However, over the longer term, we believe that it will benefit from both structural tailwinds and relatively quicker economic recovery. For Thailand, we expect the market to remain choppy as investors' focus will be fixed on the pace of vaccination, COVID-19 cases, and politics. Over the longer term, an improving vaccination rate should pave the way for market recovery. In terms of Malaysia, we expect lingering concerns to continue putting pressure on the market. Furthermore, Malaysia's parliament is set to reconvene on 26 July, which could potentially lead to greater political uncertainty and disrupt implementation of key economic measures. We are positive on Asian equities. We believe the positive sentiment in markets has not been derailed. Any economic impact from renewed lockdowns will be better quantified and managed compared to last year.

CHINA & HONG KONG EQUITIES

The People's Bank of China (PBoC) begun its policy normalization in the interbank market by rolling back liquidity supports and then shifted to rein in credit growth. So far, the tapering has been faster and sharper than expected. Although policy communication reiterated no abrupt turn in macro policies, total social financing (TSF) growth – the broad credit proxy – continued to surprise on the downside in the past months. TSF's growth rate of 11% year-on-year in May was already close to pre-COVID-19 level (10.7% year-on-year in late 2019). The unexpected liquidity tightening ahead of the Chinese New Year was another reminder of embedded tightening bias when the equity and housing markets were boiling. Economic growth momentum moderated, due in part to the weakening credit and fiscal impulse. Meanwhile, consumption recovery lagged behind. The MSCI Hong Kong went down in June (-1.84% in USD terms, net dividend). The total number of new confirmed cases picked up modestly to 80 in June (May: 60), of which 3 were locally transmitted. The total number of vaccinations reached 3.7 million with 1.5 million people fully vaccinated.

PBoC governor conveyed a clear message that the central bank would look at average inflation rates instead of the recent high levels in the Producer Price Index (PPI). Hence, we expect the PBoC to stay behind the curve in the second half of the year, in particular as growth recovery momentum has slowed and inflation risks are easing. Consumption growth was soft and the tourism recovery stalled in June due to renewed restrictions amid outbreaks in Southern China. As a result, we have downgraded our full-year growth forecast by 0.3 point to 8.9%. Hong Kong's headline Consumer Price Index (CPI) rose 1% year-on-year in May. After netting out the effects of the government's one-off relief measures, underlying CPI inflation ticked up modestly to 0.2% year-on-year. We remain positive on Chinese equities. Although growth was weaker than expected and industrial output growth also slid at a faster-than-expected rate, we believe part of the weakness can be attributed to supply restrictions. Policy adjustment and slower deleveraging are expected ahead, which await to be confirmed at the end-July Politburo meeting. We are neutral on Hong Kong equities. Hong Kong's labour market recovered further, with the unemployment rate down to 6% in May. However, the timing of opening of borders is still unclear, it may affect Hong Kong's recovery pace.

GLOBAL BONDS

U.S. Treasuries had a positive quarter. Macro data overall was strong and indicated a healthy expansion. Manufacturing output remained very strong with the PMI ranging from 59.1 in March to the record high of 62.1 in June. In this environment over the quarter, the U.S. yield curve flattened. During Q2, the U.S. 2-year yield rose +0.09% from +0.16% to +0.25%; further out the curve, the U.S.-10 year yield started the quarter at +1.74% and finished at +1.47%. The spread between the 2-year yield and the 10-year yield tightened, moving from approximately +1.58% to +1.22%. The 10-year U.S. breakeven inflation rate started the quarter at approximately 2.4%, finished the quarter at 2.3% on the back of reduced inflation. During the quarter meeting, the ECB President Christine Lagarde reaffirmed the overall dovish tone confirming it was still early to withdraw the monetary stimulus. The ECB is expected to maintain its support for the European economy in 2022/2023. The J.P. Morgan Emerging Markets Bond Index Plus Composite had a positive quarter rising by +4.4%.

In the U.S., we are seeing persistent inflation, amid an environment of rising yields and massive fiscal deficit. Markets seem to have bought the Fed's narrative of temporary inflation that prevented any hike in yields for the time being, but we believe the general direction of rates would be upward. Hence we prefer Treasury inflation-protected securities. In Europe, we believe that an improving economy (in light of the Next Gen EU plan), reopenings and inflation pressures could result in an upward move in yields. However, we acknowledge that the continued conviction of the ECB to maintain policy support and easy financial conditions should prevent any quick increase in yields. We are cautious on government bonds. Fundamental picture still supports higher levels of rates and a steeper curve. The U.S. 10-year Treasury yield fell below last months' range, we attribute the recent downward move mostly to technicals and re-positioning together with risk sentiment. We remain positive on credit. We prefer idiosyncratic opportunities to add value. The economic backdrop is strongly in favour of the trade as global reopening should maintain supportive fundamentals and risk sentiment is favourable.

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