BCT MARKET OUTLOOK

As of Mar 2021

BCT 銀聯集團

A year after COVID-19
The market is optimistic about economic recovery in Asia

Investment Markets	BCT's Investment Views	Summary
Equities		
US		We are neutral on U.S. equities. A successful vaccination programme so far, expectations of stimulus, and the ability of companies to pass on rising input prices to consumers bode well for a profit recovery this year. However, excessive valuations in some segments, the possibility of higher taxes, and new COVID-19 strains are crucial factors to consider.
Europe		We are neutral on European equities. We continue to believe this should be a year of recovery, but the need for selection is even higher now as markets are fully pricing in a recovery.
Japan		We are positive on Japanese equities. We remain positive on Japan in light of an improving global economic situation, given the market's cyclicals and industrials tilt. The country's improving shareholder focus and growing return on equity is not yet appreciated by the market.
Asia ex Japan		We are positive on Asian equities. Despite some concerns over COVID-19, Asia offers attractive bottom-up opportunities as the region's growth prospects remain intact. However, the evolution of U.S.-China relation is an important factor.
China & HK		We are still positive on China, even if at a lower extent, giving more emphases to value factor. China is the only economy to have already recovered to pre-COVID-19 GDP levels. We are positive on Hong Kong equities. Relief measures announced by the government should support the local market.
Global Bonds		
Government Bonds		On government bonds, we are now neutral. Upside pressure on U.S. bond yields could continue, driven by rising inflation expectations and the exceptional fiscal boost. However, the Fed will tend to avoid extreme moves of yields, in order to keep financial conditions supportive. We stay positive on credit, as demand for carry and central banks' purchases support the asset class.
Credit		

Scales of weighting	Underweight	Neutral	Overweight

U.S. EQUITIES

The S&P 500 started off strongly, but as bond yields started to creep up, investors turned to be more cautious and the index ended the month up +2.8%. The large majority of companies that released their earnings reports have reported positive surprise on earnings, driving the market up. Investors have jumped into a "return to normal" trade, betting that any future COVID-19 outbreaks in the U.S. would be more manageable. The vaccine approvals and production are positive, boosting expectations of a quick return to economic normality. As immunity levels rise and hospitalization rates fall, investors' new focus is the growth and its effects such as inflation. Investors anticipated a large additional fiscal stimulus from the U.S. administration. The prospect of a US$1.9 trillion stimulus package, limited demand, and a loose monetary policy from the Federal Reserve (Fed) have risen inflation expectations, with the market pricing the first rate hike by December 2022. February's Purchasing Managers' Index moved to 60.8 from 58.7, confirming another month of strong production: a mix of economic stimulus and post-crisis hopes for a return to normal favoured optimism in the business expectations. Chairman Powell's message on monetary policy was dovish, as inflation was not perceived by the Fed as a threat to its current accommodative stance, while the rise in bond yields was seen as driven by good fundamental reasons.

The U.S. economy recovery will be underpinned by the combined support of monetary and fiscal levers, as we expect an additional US$1 to1.2 trillion fiscal package in early 2021. We have consistently revised up our growth and inflation forecasts. This upgrade does not compromise our view of a still accommodative monetary policy stance, in a context where inflation does not change regimes, but follows a temporary inflation overshoot. While the output gap would close by the end of 2021, the labour market slack would be absorbed more slowly, which would limit core domestic inflationary pressures. We are neutral on U.S. equities. A successful vaccination programme so far, expectations of stimulus, and the ability of companies to pass on rising input prices to consumers bode well for a profit recovery this year, which has also been hinted at by the ongoing earnings season. However, excessive valuations in some segments, the possibility of higher taxes, and new COVID-19 strains are crucial factors to consider. Overall, investors should remain selective.

EUROPEAN EQUITIES

European equity market had a positive trend in the first part of the month, followed by increasing worries due to a rebound of economic growth, potentially causing higher inflation. Divergences emerged among the countries, confirming the dependence of economies on successful vaccination. The MSCI Europe appreciated by +2.4%. The ongoing vaccination campaigns across the Eurozone boosted economic confidence in February, as both consumers and businesses expressed stronger optimism about economic recovery. The Eurozone manufacturing output advanced from 54.8 to 57.9, with growth recorded across broad markets and producers benefitting from resurging demand for goods in both domestic and export markets. The inflation data released for February saw the Eurozone annual inflation as stable since the previous month, at +0.9%. In Germany, Q4 GDP data was revised up, unexpectedly to a growth rate of 0.3% from an initial estimate of 0.1%, on strong exports and solid construction activities. From a monetary perspective, Christine Lagarde, signalled that the European Central Bank (ECB) is closely monitoring the recent rise in bond yields, as they represent quite a relevant factor among financial conditions.

After a technical recession between Q4 2020 and Q1 2021, we expect Eurozone growth to accelerate from the second part of the year onwards, benefitting from progress on the vaccination campaign and the deployment of Next Generation EU. In the short term, economic performance remains dependent on activity restrictions imposed to prevent the spread of COVID-19. Inflation will progress along an upward path, and will be very volatile on transitory factors and base effects, while remaining below target. Fiscal and monetary policy will keep accommodating the recovery. We are neutral on European equities. We continue to believe this should be a year of recovery, but the need for selection is even higher now as markets are fully pricing in a recovery, despite some ground to cover on the vaccination front. While positioning for a recovery, investors should also have exposure to quality defensive stocks, all the while focusing on fundamental analysis. Value and cyclical stocks continue to offer opportunities, along with small caps closely linked with the recovery.

JAPANESE EQUITIES

Japanese equities rose sharply in early February, before giving up some of the gains. The Nikkei 225 advanced by +4.7%. Sentiment was boosted by improved global growth prospects and robust quarterly corporate results, which included healthy full-year guidance. Economic recovery continued in Q4, despite the winter outbreak, with all sectors managing to expand from a quarter ago. Exports were exceptionally strong, where growth strengthened further. The COVID-19 state of emergency should be lifted in March, thanks to the vaccine rollout.

Following a higher-than-expected Q4 growth figure, we upgraded our forecast to slightly positive, as resilient external demand is likely to cancel out weakness in private consumption.

We expect inflation to climb out of negative territory on firmer demand, but the full-year average will stay subdued at close to zero. The central bank will conclude and release its monetary policy review at the March meeting, with possible changes in two areas: 1) yield curve control guidance, for 10-year or longer tenors; the Governor said the declines in long yields are not desirable 2) ETF purchases: the Bank of Japan started reducing its purchases in May 2020, and at a much slower pace over the past three months (around 200 billion yen per month versus its guidance of 6 trillion yen per year). We are positive on Japanese equities. We remain positive on Japan in light of an improving global economic situation, given the market's cyclicals and industrials tilt. The country's improving shareholder focus and growing return on equity is not yet appreciated by the market.

ASIA EX-JAPAN EQUITIES

Asian equity market performance was mixed over the month. The MSCI Asia ex-Japan was up 1.4% in February. Investor sentiment was supported by a number of factors: a meaningful decrease in new COVID-19 cases; a faster-than-expected rollout of COVID-19 vaccines; the prospects of U.S. fiscal stimulus; and improved global growth prospects, with the large-scale reopening of economies now expected over the second half the year. Towards the end of the month, expectations for faster growth and higher inflation prompted a sell-off across equity markets. On 5 February, the Reserve Bank of India (RBI)'s Monetary Policy Committee voted unanimously to leave the policy repo rate unchanged at 4%. The decision was widely expected by the market, despite headline inflation decreasing sharply in December to 4.6% from 6.9% year-over-year, and finally within the target range. Furthermore, the Indian government announced a surprisingly pro-growth budget for the 2022 fiscal year, increasing its fiscal deficit target for the current and next fiscal years and moderating the anticipated path towards more fiscal discipline.

In India, fiscal expenditure is expected to lean towards higher capital expenditure, highlighting the government's intention to promote more sustainable growth. Debt is expected to revert thanks to high growth levels. We expect inflation to trend higher from March (without breaching the target as in 2020) and the RBI to remain on hold for the rest of the year. The normalisation is expected to stem from the liquidity injected into the system rather than from the policy rates to counterbalance the budget inflationary push. We think that the Asian region continues to be attractive to investors: it remained very resilient last year in terms of foreign direct investments in an overall weak environment. Earnings growth in the first half of 2021 will be more resilient in the recovery and much more linked to booming e-commerce profits. We are positive on Asian equities. Despite some concerns over COVID-19, Asia offers attractive bottom-up opportunities as the region's growth prospects remain intact. However, the evolution of U.S.-China relation is an important factor. We stay active in the heterogeneous area, focusing on stock selection and valuations, and looking for catalysts for sustained dividend yields and robust businesses.

CHINA & HONG KONG EQUITIES

China was negative over the month, with the MSCI down -1.0%, as some large internet stocks lost some grounds. Sector rotation out of growth into value was evident in February with Chinese internet, electric vehicle and consumer stocks plunging on profit taking pressure while rates-sensitive sectors gained momentum. The latest set of high frequency data suggested China's economy held up better than we expected amid the winter outbreak. Despite the steep decline of inter-provincial travel, local mobility and consumption were little affected. Retail sales and catering sales during the Golden Week were up +28.7% from a year ago. The resurgence of COVID-19 cases in three northern Chinese cities prompted the government to escalate pandemic containment measures aggressively, just ahead of the Lunar New Year, leading to a plummet in travel during the holiday season. The MSCI Hong Kong went up +4.8% in February. The government released the budget for the 2022 fiscal year. The fiscal deficit reached a record high, about 9.4% of GDP, due to the counter-cyclical measures and several rounds of anti-epidemic funds since 2020. Hong Kong government has announced a series of relief measures to support the household and corporate sectors (consumption coupons, reduction of salary taxes, provision of rate concession for domestic properties, electricity subsidy, etc.).

In China, the staycation could be a boost to industrial production, as the return to work has been smoother than the previous holiday season. With an ongoing recovery, we expect inflation to show an uptrend in the first part of the year. The unexpected liquidity tightening ahead of the Lunar New Year shows that the People's Bank of China (PBoC) is normalising its policy with a tightening bias. We continue to believe that interbank rates will anchor around the PBoC's 7-day repo rate at 2.2% and the 1-year medium-term lending facility rate at 2.95%. The one-year loan prime rate will be left unchanged at 3.85% to avoid overtightening. The risk of a rate hike this year remains low as policy easing has started to withdraw on all fronts. We are still positive on China, even if at a lower extent, giving more emphases to value factor. China is the only economy to have already recovered to pre-COVID-19 GDP levels. In Hong Kong, the vaccination program has started, but the impact will be reflected in Q2. We are positive on Hong Kong equities. Relief measures announced by the government should support the local market.

BCT 銀聯集團

GLOBAL BONDS

Bond yields underwent relatively rapid increases as data was expected to lead to better-than-expected economic growth outcomes in the U.S. and the U.K.. In Europe, Australia and Japan, bond yields also rose in sympathy. Credit markets remained supported by positive risk sentiment and spreads held up relatively well to the sharp increase in bond yields on cash credit markets. Global investment grade and high yield spreads tightened over the month. The U.S. 2-year yield rose by +0.02% to +0.13%, and the 10-year yield started the month at +1.07% and finished February at +1.41%. With better revised macro data the German Bund experienced a steepening of the curve with rising yields: having started the month at -0.52%, German 10-year yields finished February at -0.26%. The Italian 10-year outperformed other government bonds and the spread with the 10-year German Bund tightened, moving from +1.16% to +1.02% thanks to the positive reaction to the former ECB President Draghi becoming the prime minister.

Recovery is still our likely scenario for 2021, but divergences among countries are emerging as the main feature of this phase. At country level, China is the only economy to have already recovered to pre-COVID-19 GDP levels. The U.S. is pulling ahead of Europe as earlier fiscal boost and a more effective vaccine strategy created a much smaller gap against the pre-pandemic trend in the U.S. than in the Eurozone. Inflationary pressures are rising globally, but are more significant in the U.S. On monetary policy, divergences are emerging between developed markets (DM) and emerging markets (EM), with DM central banks still on the accommodative side and EM central banks starting to reduce monetary easing. On government bonds, we are now neutral. Upside pressure on U.S. bond yields could continue, driven by rising inflation expectations and the exceptional fiscal boost. However, the Fed will tend to avoid extreme moves of yields, in order to keep financial conditions supportive. In the Eurozone, yields look more capped by the gap with the U.S. in terms of potential fiscal support and ongoing impacts of restrictions on growth. We stay positive on credit, as demand for carry and central banks' purchases support the asset class.

"BCT" - BCT Financial Limited (Plan Sponsor)
- Bank Consortium Trust Company Limited (Trustee & Administrator)

Issued by BCT Financial Limited

The content of this Market Outlook is contributed by Amundi Hong Kong Limited.