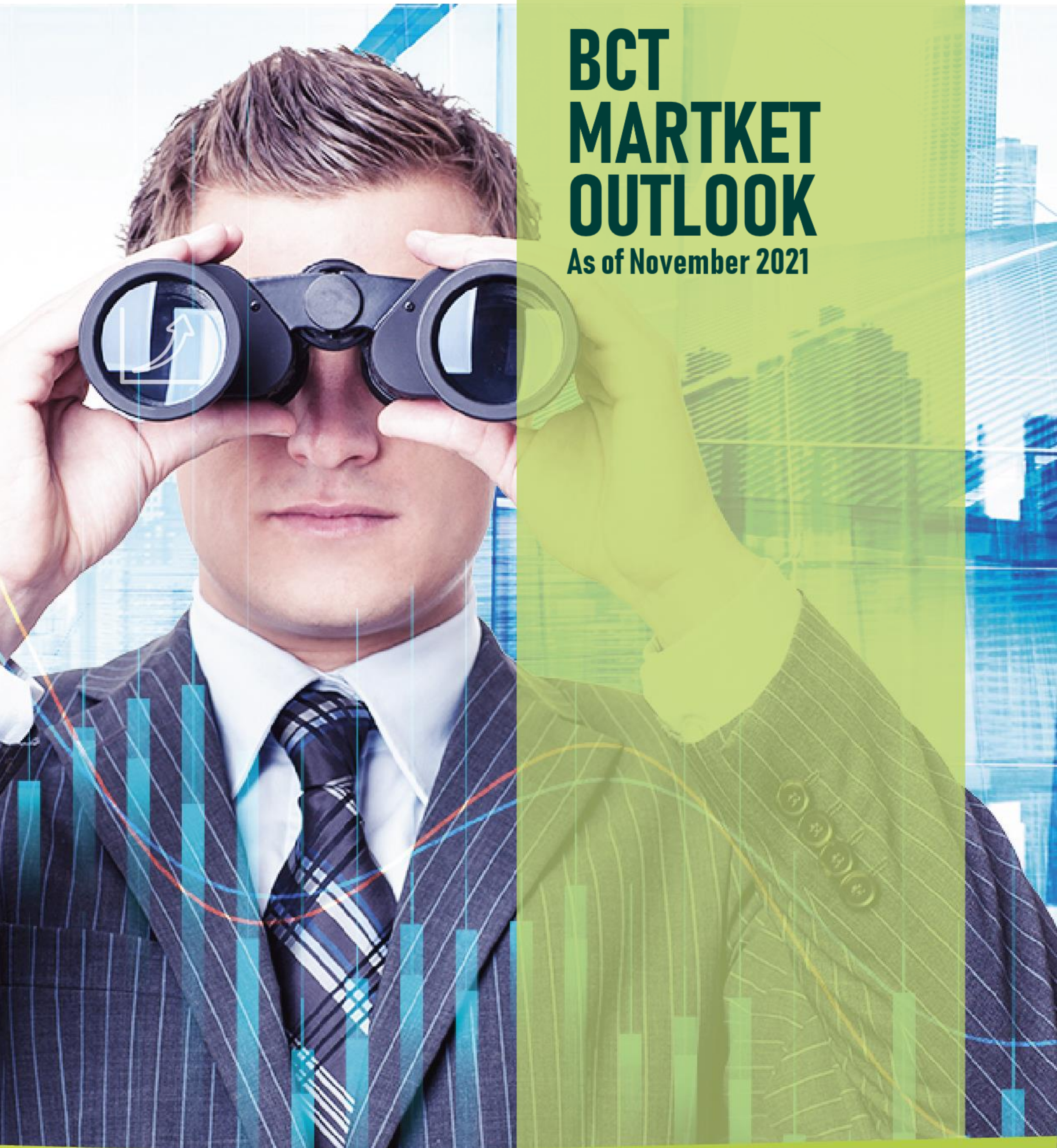
BCT MARTKET OUTLOOK

As of November 2021



SUPPLY CHAIN CRISIS CONTINUES AND INFLATIONARY PRESSURES ARE HEATING UP

Investment Markets	BCT's Investment Views	Summary
Equities	▬	
 US	▬	We are neutral on U.S. equities. Valuations are expensive and we expect a normalization of earnings growth over the next couple of years. Focus is on companies that can withstand rising inflation, sustain earnings growth and preserve margins despite rising input costs and supply shortages.
 Europe	▬	We are neutral on European equities. We prefer attractive defensive names. Overall, we look for opportunities that offer strong risk/reward profiles, and hence avoid expensive growth names.
 Japan	▬	We are neutral on Japanese equities. Given that Japan is a more cyclical market, equities should remain supported by an earnings catch-up as new COVID-19 cases recede and reopening continues. A weaker yen should further support this.
 Asia ex Japan	▬	We are neutral on Asian equities. As vaccination rates are climbing in Asia, economies will gradually reopen with mobility picking up and normalisation of earnings, but there are some risks mainly linked to deceleration of China growth, so the case for selection is high.
 China & HK	▬	We are cautious on Chinese equities due to weakness in growth and potential regulatory measures. We are neutral on Hong Kong equities. Unemployment rate improved from 4.7% in August to 4.5% in September, as the number of COVID-19 cases are low and economic activities gradually recover.
Global Bonds	▬	
Government Bonds	▼	We are cautious on government bonds. In the U.S., we believe U.S. Treasury could be under pressure, but the risks of inflation derailing a recovery mean that central banks may be unwilling to implement substantial tightening.
Credit	▲	We remain positive on credit. In the U.S., credit fundamentals are constructive but we are exploring the asset class through a highly selective lens that allow us to limit our beta.

Scales of weighting	▲ Underweight	▬ Neutral	▼ Overweight

U.S. EQUITIES

The S&P 500 achieved new peaks with a monthly gain of +7%. More than 80% of the U.S. companies beat earnings expectations. Hopes for additional fiscal stimulus and progress on social infrastructure plans also contributed to bolstering sentiment. Supply chain woes and labour shortages had limited impact on corporate earnings so far. Growth stocks outperformed value stocks with a gain of +9% against a +4.4% return for value stocks. Gross domestic product (GDP) grew at a +2% annualized rate in Q3, its slowest gain of the pandemic-era recovery. Supply chain issues, a decline in auto sales, and a slowdown in spending on food services and accommodations due to the Delta variant weighed on the U.S. economy. Pending home sales also fell unexpectedly. Overall, the U.S. recovery still remained solid and the economy is approaching full employment with inflationary pressures building: U.S. labour market data highlighted the impact of worker shortages with wages increasing by a robust 5.5% year-on-year. The evidence of slowing growth helped drive a retreat in intermediate- and long-term U.S. Treasury yields.

Inflation, even if it peaks in the coming quarters, is likely to affect equity valuations, underscoring the need for investors to protect their portfolios from rising prices. In addition to base effects and energy prices, a key aspect pushing inflation up is worker wage growth, which has been developing for quite some time now. We believe value stocks provide an opportunity to inflation-proof portfolios but these require strong selection. As investors, our capital should be tilted towards companies that will support the environmental, social and governance (ESG) transition, in the process benefitting from the move. We think this transition is one of the most important solutions to take us to net zero emissions by 2050. We are reducing cyclicality in global sectors affected by higher logistics and input price risks. We avoid expensive growth and distressed value stocks, but focus on relative value. We are neutral on U.S. equities. Valuations are expensive and we expect a normalization of earnings growth over the next couple of years. Focus is on companies that can withstand rising inflation, sustain earnings growth and preserve margins despite rising input costs and supply shortages.

EUROPEAN EQUITIES

The MSCI Europe advanced +3.7% in local total return terms in October. Equity in Europe rose as optimism about corporate earnings overcame worries about the potential risks of reining accommodative central bank policies. In Europe, inflation grew in October: on an annual basis, Eurozone consumer prices reached 4.1% according to a flash estimate - up from 3.4% in September. Inflation numbers were driven by rising energy costs, tax increases and growing price pressures as a result of the ongoing supply chain crisis. According to preliminary estimates, Eurozone economic growth increased by +2.2% quarter-on-quarter, higher than expected, with France and Italy beating expectations due to a rise in consumer spending and export. However, economic growth seemed to have lost momentum with Eurozone Purchasing Managers' Index (PMI) slowing in October (58.3), down from 58.6 in September and early estimate of 58.5. From a monetary perspective, at its October meeting, the President of the European Central Bank (ECB), Christine Lagarde, acknowledged that supply chain bottlenecks were likely to persist into next year. Therefore, inflation could take longer to decline than ECB officials had initially expected. However, she reiterated the view that the rate of consumer price increases should slow to less than 2% by 2023. She stated that the ECB’s forward guidance (the central bank will hike rate when medium-term inflation converges to 2%) was inconsistent with a lift-off in 2022 or “anytime soon thereafter” as currently priced by the market.

We maintain a balanced stance, with a tilt towards normalisation and reopening, and we implement this view through a barbell approach of quality cyclical stocks in value. Here, the economic reopening is not fully discounted by the market and thus valuations are selectively attractive. On the other hand, the picture in consumer sectors looks mixed. In the latter, we have become more cautious in our view because of the strong run lately and we are looking for answers beyond the earnings season, especially in terms of the impact of green investing on the broader green energy landscape. We think there is a need to invest in sectors with an ESG improver approach that could have a meaningful impact and push clean energy investments. We are neutral on European equities. We prefer attractive defensive names. Overall, we look for opportunities that offer strong risk/reward profiles, and hence avoid expensive growth names.

JAPANESE EQUITIES

In October, Japan had a negative performance with the TOPIX and the Nikkei declining -1.4% and -1.9% in total return terms, respectively. As widely expected, the Bank of Japan (BoJ) left its policies unchanged at its October meeting. In its new Quarterly Outlook Report, the central bank downgraded its 2021 GDP growth forecast slightly given the delay in the anticipated consumption recovery due to COVID-19 complications. Core Consumer Price Index (CPI) inflation was also downgraded sharply due to the one-off base revision. Fumio Kishida took office as Japan's new prime minister, setting up the prospect of a continuation in supportive monetary and fiscal policies. At home, Japan has begun to lift its state of emergency gradually since September, as the full vaccination rate climbed to over 70%, paving the way for a recovery in private consumption.

As the full vaccination rate reached over 70%, we expect consumer demand and inflation to strengthen gradually. However, the core reading is likely to stay below the BoJ's 2% target in 2022-2023, delaying policy normalisation. We, however, maintain our view of soft inflationary pressures in 2021, expecting limited pass-through from surging energy prices. Inflation will increase at a faster pace in 2022, as transitory factors fade out. The election performance of the Liberal Democratic Party (LDP) under the leadership of Mr. Kishida is shy. The party is estimated to lose as many as 40 seats. If the LDP lost only 15 seats, it would maintain an absolute majority. Together with the seats obtained by its partners, the ruling coalition retains a majority of seats in all standing committees and therefore has complete legislative control. We are neutral on Japanese equities. Given that Japan is a more cyclical market, equities should remain supported by an earnings catch-up as new COVID-19 cases recede and reopening continues. A weaker yen should further support this.

ASIA EX-JAPAN EQUITIES

In October, it was a mixed story in Asia where many indices delivered positive returns with some exceptions. At the beginning of the month, shares experienced an appreciation on the back of positive earnings and a drop in COVID-19 cases. However, natural gas prices increased due to demand/supply imbalances in Asia. In terms of gas production, Asia has historically been one of the largest net importers. Hence, equities were weaker towards the latter part of the month. Amongst the major equity indices, top of the table was the Indonesian Jakarta Stock Price Index (JCI) of +4.8%, the Singaporean Straits Times Index (STI) had a positive month with a return of +3.6%, and the Philippines Stock Exchange Index (PSEi) was up by +1.5%. The Stock Exchange of Thailand (SET) also gained +1.1% whilst in India, both the Sensex and the Nifty 50 were up by +0.3% during the month, weaker than prior performances due to concerns over inflation. Similarly, the Taiwan Stock Exchange Corporation Index grew by +0.3% whilst the export-oriented Korea Composite Stock Price Index (KOSPI) fell -3.2%, the KOSPI recorded the weakest index market in October, although technology names were enhanced by positive earnings.

In emerging markets (EM), the weakness is more broad-based, starting from China but concerning other countries too (such as India). The growth premium is expected to remain in favour of developed markets against EM over the next few months. On the positive side, we observe South Asian economies walking away from the zero tolerance policy – this factor could support future growth dynamics. Inflation trends are mixed, with high inflation pressures in other EM regions and a benign environment in Asia. Central banks' stances reflect such discrepancies – we observe tighter stances among other EM regions and economies while Asian central banks are reluctant to progress with any normalization. We are neutral on Asian equities. As vaccination rates are climbing in Asia, economies will gradually reopen with mobility picking up and normalisation of earnings, but there are some risks mainly linked to deceleration of China growth, so the case for selection is high.

China & Hong Kong Equities

The Hong Kong Hang Seng Index experienced an appreciation of +3.3% while by contrast the Shanghai Composite returned -0.6%. Investor concerns around the Chinese property sector eased slightly after Evergrande, a large property developer, made interest payments that had previously been missed in September. In China, growth numbers broadly surprised on the downside in Q3, with exports being the only exception. Policy tightening, self-imposed restraints (zero tolerance COVID-19 policy and decarbonisation policies), and the global chip shortage all contributed to the slowdown. CPI inflationary pressures remain subdued as services consumption has been hit hard by the COVID-19 zero-tolerance policy, as we enter the winter season in the northern hemisphere, the rising number of COVID-19 cases is reviving fears of a new wave. China is witnessing a resurgence of the outbreak, despite its mass vaccination campaign, but with a less effective vaccine.

We expect China's GDP to grow +7.7% and +4.7% in 2021 and 2022 respectively, down from estimations of +8.3% and +4.9% a month ago. Despite the relaxation of social distancing rules, a confluence of factors continues to weigh on economic recovery, including housing slowdown. Services consumption and infrastructure investments are likely to bounce back, cancelling out part of the slowdown. Inflation-wise, higher Producer Price Index (PPI) data are likely given the prevailing supply constraints. The CPI should remain subdued with a bumpy consumption recovery.
Marginal changes in housing policies are also underway. The People's Bank of China (PBoC) urged banks to correct their over-execution of macro-prudential policies. The delayed loan disbursement to developers and prolonged mortgage approvals are likely to ease. We are cautious on Chinese equities due to weakness in growth and potential regulatory measures. We are neutral on Hong Kong equities. Unemployment rate improved from 4.7% in August to 4.5% in September, as the number of COVID-19 cases are low and economic activities gradually recover. Hong Kong policy address emphasized public housing supply and did not mention regulation and policy towards private residential, Hong Kong developers rebounded.

GLOBAL BONDS

The Federal Reserve (Fed)'s monetary policy and unconventional tools for pumping extraordinary amounts of liquidity provided formidable support to the 2021 equity rally, besides strong rebound in profits and economy. Liquidity adjusted valuation metrics had been in cheap territory with few exceptions so far. High borrowing, aggravated by the fiscal response to the COVID-19 crisis, combined with economic reopenings, supply shortages and demographics, were pushing inflation up. Overall, the J.P. Morgan Economic and Monetary Union Government short-dated bond indices had negative returns during October, as short and mid-term yields rose in core markets. The 3-5 year index fell -0.8% whilst the 5-7 year index posted a negative return of -1.2%. While financial repression (government borrowing below market rates) works when inflation is under control, this is a problem for asset values. Even some central banks that kept rates low are realising that inflation is not transitory.

We believe the Fed and the ECB are likely to taper but will refrain from extreme actions, although we might see asynchronous policies. Overall, liquidity will remain high. Investors should keep a close watch towards the recent upward yield movements and stay active. We are cautious on government bonds. In the U.S., we believe U.S. Treasury could be under pressure, but the risks of inflation derailing a recovery mean that central banks may be unwilling to implement substantial tightening. TIPS (Treasury Inflation-Protected Securities) offer inflation-protected returns but there are valuation concerns. In Europe, we remain defensive and agile on core and semi-core European government bonds. On periphery debt, however, we are positive due to the recovery and support from the Next Generation European Union fund, but are monitoring political risks. We remain positive on credit. In the U.S., credit fundamentals are constructive but we are exploring the asset class through a highly selective lens that allow us to limit our beta. We are also watchful of the risks from rising core yields at the moment. In Europe, fundamentals continue to improve, albeit at a slightly slower pace, and liquidity remains high. However, we increase the selectivity in our portfolios to look for companies that can pass on the increase in costs to consumers.