BCT Market Outlook

July 2015

US Equities

The Fed held rate unchanged, but lowered its GDP forecast and maintained interest rate forecast this year at 0.625% while cut that of 2016. Besides, the Fed addressed that rate hike would be data-dependent, including further improvement in labour market and confidence on medium-term inflation rising towards the 2% target, while saying rate hike was possible this year. Moreover, May's non-farm payroll added 280K, further improved from April's revised 221K, and average hourly earnings was up by 2.3% year-on-year, slightly speeded up from April's 2.2%. And May's ISM Manufacturing rebounded from 51.5 in April to 52.8, which showed signs of picking up in momentum of manufacturing expansion.

In general, the Fed statement remains largely the same as last meeting, but more emphasis on gradual rate hike path and calms the markets on the potential strikes by first rate hike. Meanwhile, employment, wage growth and housing are on track of recovery, but inflation still lacks momentum and casts uncertainty on the timing of rate hike. Investor should eye on dollar strength and oil prices for their impacts on exports and corporate earnings which in-turn affect the recovery and rate hike schedule. On the other hand, the overvaluation on US markets relative to the 10-year average price-to-earnings ratio persists and we maintain NEUTRAL stance.

European Equities

Greece proposed new measures to its creditors which includes restricting early-retirement, increasing pension contribution, adding income tax to the wealth and rising corporation tax and value-added tax (VAT) of certain goods. Also, Greece enacted capital control to avoid capital outflows and called a referendum, while ECB did not further rise the emergency liquidity assistance (ELA) to Greek banks. On the other hand, the ECB maintained interest rate unchanged, revised the inflation forecast for eurozone in 2015 from 0% to 0.3%, and added that the ECB was committed to fully implement the QE programme. However, the Eurozone's ZEW survey expectations dropped from 61.2 in May to 53.7, while that of Germany fell from 41.9 to 31.5, showed deterioration in economic confidence for both regions.

Even Greece escaped from default, debt negotiation will come again someday and cast shadow on Eurozone's financial stability, yield movement and recovery. Also, the declining economic outlook of Germany posts threat to the Eurozone recovery as a unity. Moreover, although the ECB held its stance to keep QE and revised its outlook to inflation upward, movement of risky assets will still rely on solid and sustainable improvements in fundamentals which is not seen now. We hold NEUTRAL view to Europe on uncertainties in credit and fundamentals.

Japanese Equities

The BoJ maintained its QE programme, targeted at 80 trillion yen annual increase in monetary base. Besides, economic and inflation outlook report would be released quarterly instead of semi-annually. In addition, the finalised GDP in 1Q was up by 3.9% (annualised) compared with previous quarter, revised upwards from 2.4%, in which GDP business spending was revised upwards from 0.4% to 2.7% and GDP private consumption remained unchanged. Also, labour cash earnings jumped 0.6% year-on-year in May, and household spending rose 4.8% year-on-year, reversed from April's -1.3%. However, company profits in 1Q only rose 0.4% from previous year, largely retreated from 4Q14's 11.6%.

The encouraging GDP growth in 1Q was mostly supported by business spending, in which private consumption has yet to improve. Although household spending improved in May, its sustainability is in doubt, consumer spending still constitutes an obstacle to sustained recovery. Besides, inflation is still far from the 2% target, which allows the BoJ to act further. Moreover, in expect of US rate rise, yen is likely to depreciate further, favours export, but at the same time total equity return may suffer. We hold NEUTRAL stance.

Asia ex Japan ex Hong Kong Equities

The Fed stated that rate hike is possible this year, depends on economic data. Besides, liquidity was driven out from the regions on US rate hike concerns, markets extended loss in June. For specific countries, Korea cut interest rate to historical low of 1.5% to tackle potential impact to tourism and economy by MERS. Also, the Indian Central Bank cut interest rate but addressed inflation risk, while the year-on-year growth of CPI in May speeded up from April, casting concerns on room for further easing, market declined. In addition, Indonesia and Malaysia declined on worries on growth by poor trade figures and sustained currency depreciation which limited accommodative measures.

Capital outflows are likely to persist under the shadow of US rate hike, it should be cautious on spike in market volatility. For emerging markets, currencies and equities could move in same direction and result in enormous loss in total equity return under adverse condition, and currency depreciation may be enlarged under easing policies. It is worth to note that currencies depreciation should be encouraging to export, but demand of goods within the regions also plays a key role in the trade performances. We hold NEUTRAL for the regions on its liquidity sensitive nature and possible market correction.

China & Hong Kong Equities

The PBoC lowered interest rate for the 3rd time in 2015 by 0.25% and at the same time announced targeted cut to the reserve requirement ratio by 0.5%. And the authority cancelled the requirement for loan-to-deposit ratio for banks. In addition, the CSRC limited the amount margin financing and short selling of brokerages to no more than 4 times of their net capital, and strengthened the regulatory act on market manipulation and umbrella trust. Besides, MSCI declined to include A shares to its benchmark index, led to capital outflows from the markets. Moreover, an additional RMB 1T was added to the debt-for-bond swap programme to refinance local government debts, totalled to RMB 2 trillion. Meanwhile, the year-on-year growth of industrial production speeded up from 5.9% to 6.1% in May, while credit rebounded from April.

Relatively high real interest rate enables room for further rate cut to tackle disinflation and simulative housing policies are also anticipated in face of uneven rebound in housing market and economic slowdown. Also, the sustainable recovery in housing and credit are crucial to form a solid base for equity market rally, where recent rallies in previous months were mainly driven by policy anticipations but not fundamentals. On the other hand, there is still sufficient room for the brokerages to amplify the scale of margin and securities lending under new regulation. More can be done under new shares placement, and the impact to market sentiment should be temporary. We are still SLIGHLTY POSITIVE due to Chinese sufficient policy room.

Global Bonds

Treasury yield moved down from peak as encouraging employment data which supported early rate hike was counteracted by the latest Fed statement, which markets perceive as an indication of delay in rate hike, and the dollar extended weakness. On the other hand, the ECB addressed to fully implement the QE programme, but euro appreciated on improved inflation outlook by the ECB, while the yield of eurobonds moved up on the back of uncertainties on debt negotiation over Greece. In addition, the yen appreciated on encouraging 1Q GDP.

We expect USD to sustain strength and Treasury yield increment in the medium term due to rate hike. Besides, liquidity may flow out from emerging to developed markets, which could be induced by increasing expectation of US rate hike, the currencies in emerging markets may suffer. Also, euro is believed to be range-bounded on Grexit and improvement on ECB’s inflation outlook. On the backdrop of global recovery, we maintain our SLIGHTLY NEGATIVE view for overall bonds.

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