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BCT Market Outlook

August 2014

US Equities

The Fed continued to taper its QE programme, with the amount of monthly bond purchase reduced from USD 35 billion to USD 25 billion. At the same time, the Fed reiterated its low rate policy even after the end of bond purchase programme. On the other hand, the advanced 2Q annualized GDP was expanded by 4% from the previous quarter, CPI in June rose 2.1% from the previous year, while unemployment rate dropped to 6.1% which was near the 6-year low from 6.3% in May. These figures indicate that the overall economy recovery is still on track.

The bond purchase programme may come to an end in October, and the market will shift its focus to the timing of rate hike, with the current rate hike expectation to start in mid-2015. The easing monetary stance of the Fed is expected to continue, but it should be cautious on earlier-than-expected rate hike if the US economy picks up at a quicker pace. Besides, the earning season has started which should give a clearer picture on the corporate operations and its outlooks. We maintained SLIGHTLY POSITIVE on US equities based on its anticipated recovery.

European Equities

CPI in Eurozone rose 0.5% in June from last year and was still far from the ECB target of below but close to 2%. This figure extended the concern of deflation in Eurozone even after ECB cut the interest rate to negative territory. Apart from that, Eurozone unemployment rate maintained at 11.6% in May, and high unemployment rate is still clouding the economy. Moreover, retail sales in May only rose 0.7% from the previous year, slower than 2.4% in April. However, Eurozone Manufacturing PMI (preliminary) was at 51.8 in June, indicating expansion.

On the positive side, Euro further weakened under the policy act, reflecting the effect of accommodative monetary stance. That could help Eurozone boosting its exports and corporate earnings. Eurozone's economy sees signs of recovery, but less obvious than the US's. The market is still awaited to see whether the rate cut by ECB and other actions taken would be effective enough to improve the credit market and economy of Eurozone. Besides, potential escalation between Russia-Ukraine may further enhance political risk. Although the ECB maintains its continuous commitment in keeping Europe's economies going, the markets will need to see if recent policies could have the expected positive effects. To reduce market risk, we moved Europe from POSITIVE to SLIGHTLY POSITIVE.

Japanese Equities

CPI in June recorded 3.6% increment from the previous year. However, the household spending dropped 3% from the previous year, and the decline was narrowed from 8% in May, but still indicating lack of confidence in spending. Besides, the industrial production (preliminary) dropped 3.3% from previous month (May: up 0.7%) and retail sales rose 0.4% from previous month (May: up 4.6%).

Inflation has already exceeded BoJ's target (2%) and is expected to stay at a high level, but other economic figures did not see obvious improvement, limiting BoJ's flexibility on whether to further expand its monetary policies, especially when the Yen saw range-bounded movement which reflects fading effect of expansionary monetary policy on currency depreciation. Acting as a safe haven, upward pressure of Yen is also seen on the back of political conflicts around the globe, hurting the prospects of export, casting potential negative impact on Abe's monetary reform (1st arrow). Moreover, any effects on Abenomics' 3rd arrow will need time to prove and hard to have short-term impact. We maintain NEUTRAL on Japanese equities.

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Asia ex-Japan ex-Hong Kong Equities

In terms of valuation, MSCI Asia Pacific ex-Japan Index was traded at 13.2 times estimated earnings, which still enjoyed a significant discount to the 16.7 times of the US S&P's 500 Index. Attractiveness in relative valuation, positive corporate earnings, supportive trade figures and policy anticipation on certain countries such as India fuelled the rallies of ASEAN and the Indian sub-continent markets.

Apart from the factors mentioned above, the abundant liquidity provided by major central banks is expected to encourage money inflows to the regions in short-term. However, there are potentially negative factors that could reverse the uptrend such as escalated political conflicts within the regions, and the faster-than-expected rise in US interest rate. For emerging markets, the currencies usually move in the same way with equity markets, enhancing potential loss when markets are reversed. However, we are still SLIGHTLY POSITIVE on the region based on the attractive valuation.

China & Hong Kong Equities

On a year-to-year basis, the increase in CPI in June was down to 2.3% from May's 2.5%, which was still below the authority's upper limit of 3.5%. On the other hand, 2Q GDP rose 7.5% from the previous year, compared with 7.4% in 1Q, thanks to targeted monetary policies, fiscal policies enhancement such as tax reduction and stimuli in infrastructure in 2Q. Prices of coal and steel are both undergoing a downtrend, indicating weakness of industrials, threatening the economic growth.

In response to the decline of property market, several cities have relaxed the tightening policies (such as Suzhou and Jinan) which can ease the concern on the property market and the highly correlated macro-economic. Moreover, the recent strength of the HKD may indicate money inflows to equity market which favours the performance of Hong Kong stock market but also need to be cautious on the potential increase in volatility. However, based on fundamentals of the region, we maintain NEUTRAL stance.

Global Bonds

Worsened political conflicts between Russia and Ukraine, Israel and Gaza further ignited the role of major government bonds as the safe haven. In addition, the abundant liquidity supplied by the accommodative monetary policy stances by the ECB and BoJ also supported the performance of bonds. The above factors have offset the negative effects of US tapering on bond prices. Moreover, yields of emerging market bonds are still more attractive than that of the developed market bonds.

We prefer corporate bonds to government bonds due to encouraging corporate earnings. By region, emerging market bonds generally offer better yield than developed market bonds, and the "search for yield" is expected to continue which favours the prospects of the emerging market bonds. On the other hand, offshore RMB bonds are still attractive, given the currency reform and China's continuous trade surplus. Overall, we are SLIGHTLY NEGATIVE on bonds as economy recovery usually favours the performance of equities more than bonds.

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