Waiting for the Fed Lift-off

Global equities recovered strongly in October after the fallout in August and September, buoyed by dovish central bank posturing. The Fed delayed the rate hike decision, the ECB stated it would reconsider quantitative easing policy and China cut rates for the sixth time this year. We advise clients to stay invested in equities through a neutral weighting, and prefer developed markets, particularly Europe over Asia.

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Key Points

• October turned out a lighter shade of grey as risk markets clawed back into positive territory.

• While fundamentals remain largely unchanged, investors found cheer in market-friendly policy actions from central banks, against a weak inflationary backdrop and abundant market liquidity.

• China cut interest rates for the sixth time this year and lowered banks’ reserve requirements, to combat deflation and a slowing economy. The European Central Bank (ECB) also signalled support for further quantitative easing (QE) by potentially expanding its programme beyond next September if needed.

• Stronger economic growth in the U.S. augurs well for U.S. equities, in our view. However we remain cognizant that valuations are still not cheap despite the market correction in August and September. Also, the uncertainty over the timing of the Fed rate hike remains a key source of volatility.

• The macro picture in Europe is likely to stay supportive in the medium term with the ECB keen to step in with further stimulus. We also see further corporate margin improvements driven by better economic fundamentals, easier credit and cheaper commodities.

• The Bank of Japan (BOJ) kept its monetary policy unchanged during their latest policy meeting. This has since pushed back market expectations of further easing into 2016.

• Consensus earnings expectations in Japan have held up well so far, but in view of the slowdown in emerging market (EM) economies, especially China, Japan Inc. is likely to conservatively revise down their guidance for the next earnings season. On the bright side, valuations for Japanese equities remain at historical lows, likely pricing in such potential earnings revision.

• Languid growth prospects in view of weak commodity trends and higher vulnerability to U.S. monetary policy lead us to be more cautious of Asia Ex-Japan equities, even though valuations remain undemanding. We will only seek to upgrade Asia once we are safely past the impending Fed rate hike.

• Overall, we believe the solid growth momentum in the major developed countries will help to offset the struggles in some parts of the emerging world. Also, given the prevailing macro uncertainties surrounding the timing of the rate hike, we maintain our neutral stance on equities and continue to like developed markets.
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