FEBRUARY 2021

Investment Navigator
Asia Edition

Are Equities in a Bubble?

Summary

- Following a strong 2020, IPO issuance are at a record high while volatility appeared in selected equities. Are these signs of an equity market bubble forming?
- We examine the Main street vs. Wall street narrative, and any implications for markets in general.
- Focus on fundamentals with one of the best earnings seasons in over a decade, as well as improving vaccine roll-out in the US and UK. Finally, central bank accommodation will remain a buffering factor. In short, take advantage of any volatility and take what the market gives you.

Main Street vs. Wall Street

Retail investors waged war against the Wall Street hedge funds in a unprecedented short squeeze event in the last weeks of January. While details of the whole "Reddit Army" movement has been well documented online, the dynamics and impact on the financial markets were a surprise event.

In short, the combination of

(1) zero-cost online trading

(2) stimulus checks

(3) instant information

(4) popular chat rooms

(5) large numbers of people at home

(6) the recent market rally

has led to a huge increase in retail trading. The macro back drop of excess liquidity and zero or negative rates are also contributing factors in the Reddit fiasco.

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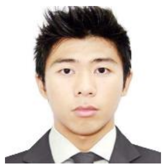

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Compared to last year's "Callmageddon" episode largely involving large cap technology stocks, the difference here is rather drastic. This time, the limelight was on selected, illiquid small and mid-cap stocks, particularly those with poor fundamentals and were hence heavily shorted by the market. The short squeeze event was a movement by David (retail), fueled by populist elements, to topple Goliath (hedge funds).

What about positioning?

In the short-term, equity markets were overbought after an incredible four-months run, and a correction is deemed healthy. We wrote in last month's Asia Navigator "We would not be surprised that any negative news could trigger market corrections at any time sooner or later." This has now happened / happening.

Ironically, overall short positioning in the S&P 500 is at 9-year lows. Hence, the short squeeze is primarily concentrated in selected small cap stocks. This is evident from the top quintile of stocks in the small cap index Russell 3000, which are up 20% year-to-date. The duration of the market impact remains to be seen, and may be still limited.

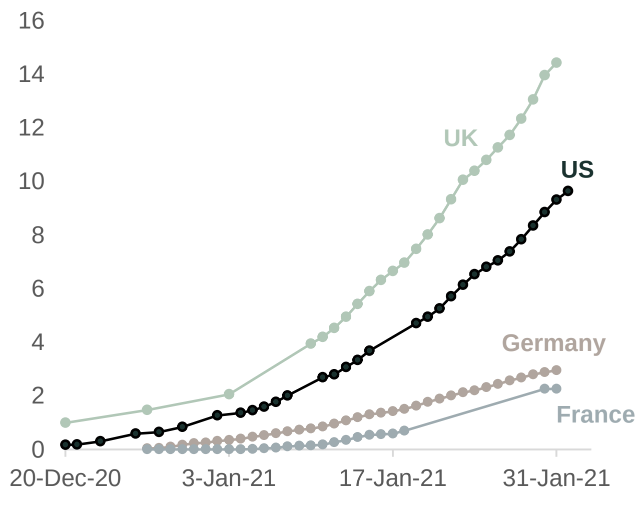
On the back of massive price swings and volatility, many hedge funds with short exposures scrambled to cap losses. This led to the largest deleveraging move since 2008, as Goliath (hedge funds) sought to cover their short positions with some even resorting to reduce long exposure to manage the volatility. The result is a reduction in the overall net market exposure of equity long / short funds from 0.8 to 0.5. CTAs have also reduced exposure. There could be further repositioning in the coming weeks, albeit this normally occurs rapidly.

Overall, equity positioning among investors, while increasing, is not flashing significant warning signals. Clearly, it will be interesting to observe how the extent of rising volatility, margin requirements as well as trading restrictions may affect OVERALL flow into equity markets. However, it is also key to note that significant cash of USD 929 billon remains in money market funds at this juncture. Additionally, saving rates are high, and that can fuel spending as reopening commences.

Vaccine roll-out

In that regard, one of the most crucial variables for financial markets is the vaccine roll-out. The good news is the pace is rapidly picking up around the world. In the US and UK, the roll-out pace has been very encouraging. The UK is leading the pack with >14 doses per population, at an incredible rate of 1% of the population vaccinated in a day. The US are well on track to reach resident Biden's target 100 million people vaccinated in his first 100 days in the oval office.

COVID-19 VACCINE DOSES ADMINISTERED PER 100 PEOPLE



Source: Our World In Data, BNP Paribas (WM), 3 Feb 2021

What about efficacy and new variants?

In terms of vaccination, no other country has done it quicker than Israel. The pioneer of vaccine roll-outs has already had approximately 40% of their population vaccinated as of end January, and is undoubtedly the barometer of vaccine efficacy.

Thus far, preliminary results have been encouraging, with a 60% drop in infections for people over 60 who took the vaccine versus those that did not. Furthermore, the Israeli health ministry released data on those over 60s who took two doses of the Pfizer/Biontech vaccine. Only 0.07% became infected, and just 0.005% needed to be hospitalized. These are significant milestones.

Clearly, there are still many unknowns including length of efficacy and emerging new strains. The good news is newly developed mRNA technology used to make Covid vaccines can be quickly adapted for new variants. In fact, drugmakers have already started working to make so-called "booster" shots for the South African variant.

What about fundamentals?

The current US earnings season is showing more than 80% of companies recording earnings beat, vs an average of 74% the last 5 years. The magnitude of the earnings beat is large at +19% vs a 5-year average of +6.3%. If this holds, it would be the second largest beat since 2008. Evidently, this reflects the exogenous shock of the pandemic.

This is important given the multiple expansion last year in global equities as markets price in recovery. We would expect the multiples to contract as global earnings accelerate this year. In short, we expect global equities to go up less than earnings growth of 28.9%. However, this should still provide some upside even after the strong performance in 2020. Furthermore, the gap between dividend yields and bond yields remain positive despite the multiple expansion. It is currently 100 to 200 bps higher than the average of the last 20 years, making equities attractive.

Yield Gap: Equities vs. Fixed Income

	Dividend Yield	10Y Bond Yield	Dividend Gap	Average Since '00	Current vs Average (bp)
US	1.40%	1.10%	0.30%	-1.40%	168
Japan	1.90%	0.00%	1.90%	0.80%	113
Eurozone	2.10%	-0.20%	2.40%	0.30%	201
UK	3.20%	0.30%	2.80%	0.50%	232

Source: Datastream, BNP Paribas (WM), 3 Feb 2021. Past performance is not indicative of current or future performance

Central banks support remains

The major central banks of the world will likely grow their balance sheet slower than that in 2020. Nonetheless, the growth is still projected to be around 15% in 2021. Interest rates will likely remain low as well. In summary, central banks will remain accommodative and induce flows into financial assets, something that has become more common of a tool since the great financial crisis.

CONCLUSION

We continue to see 2021 as a year of economic recovery, albeit the road ahead may continue to be bumpy. Importantly, the macro and earnings fundamentals remain strong for the economy and for the stock market, on the back of strong economic momentum and continued support from governments and central banks. We would thus use any stock market correction in the near term as an opportunity to add to positions, particularly in our favoured areas such as mid-/small-caps and cyclical sectors.

GDP & CPI Forecasts

		GDP (YoY%)			CPI (YoY%)		
		2020	2021f	2022f	2020	2021f	2022f
	Global	-4.0	5.6	4.0	-	-	-
Developed	US	-3.6	4.2	4.1	1.3	1.9	1.9
Developed	Japan	-5.3	1.1	3.0	0.0	-0.4	-0.3
Developed	Eurozone	-7.3	3.8	5.5	0.2	0.8	1.3
Developed	UK	-11.1	4.0	8.6	0.9	1.5	2.1
	Developing Asia	-7.7	8.7	4.5	3.6	2.8	2.8
North Asia	China	2.3	9.5	5.3	2.6	2.3	2.8
North Asia	Hong Kong*	-7.5	3.7	3.4	0.3	2.4	2.5
North Asia	South Korea	-1.0	3.1	2.9	0.6	1.1	1.2
North Asia	Taiwan*	0.0	3.2	2.1	-0.1	1.0	1.2
South Asia	India	-11.4	11.6	5.0	5.8	4.3	3.8
South Asia	Indonesia	-2.0	5.8	4.5	1.9	1.7	2.0
South Asia	Malaysia	-5.0	7.5	3.9	-1.2	-0.3	1.0
South Asia	Philippines*	-8.3	7.4	6.4	2.4	3.0	3.0
South Asia	Singapore*	-6.0	5.0	2.6	-0.4	0.3	1.1
South Asia	Thailand	-6.6	4.2	3.7	-1.3	-0.7	0.5

Source: BNP Paribas Group Economic Research, BNP Paribas Global Markets forecasts as of 31 January 2021
** IMF data and forecasts as of 31 January 2021*

GROWTH

- It will still take some months for the US to overcome the shock caused by the Covid-19. Economic growth will be driven by government expenditure, supporting consumer and business sentiment.
- We expect a sharp acceleration of economic activity from the second quarter 2021 onwards.

INFLATION

- Our inflation forecasts remain broadly unchanged for 2020 and 2021.
- After the crisis, inflation should rise very gradually to levels consistent with central banks' targets.

Equity

POSITIVE NEUTRAL NEGATIVE

OVERALL GLOBAL: POSITIVE		
Positive	Neutral	Negative
COUNTRY		
Eurozone Emerging Mkt Japan UK	US	-
SECTOR		
Healthcare Materials Industrials Real Estate	Consu. Discre. Technology Utilities, Energy, Financials Communications (Comms)	Consumer Staples (Consu. Sta.)

OVERALL ASIA: POSITIVE		
Positive	Neutral	Negative
COUNTRY		
China, Taiwan Singapore South Korea India, Indonesia	Thailand Malaysia Philippines	-
SECTOR		
Materials Industrials Consu. Sta. Healthcare Utilities	Comms Real Estate Consu. Discre. Energy ▼ Technology	Financials

- **Any stock market corrections are buying opportunities:** The recent retail investor phenomenon has caused some volatility in stock markets. However, better-than-expected earnings in the US, falling Covid new case rates, vaccine roll-out together with ultra-low real interest rates and ongoing stimulus efforts give us confidence that any stock market corrections are buying opportunities.

- **Downgrade Asian tech sector to neutral:** Asian tech stocks have seen a spectacular rally since mid-2020. We expect short-term momentum to take a breather on semi and hardware as most of the near-term positives are in the price. The fast pace of re-rating in some large cap Asian internet names is also technically unsustainable, making short-term risk/reward less attractive. We remain structurally positive on the sector, and will look to upgrade after a period of consolidation.

		1-month (%)	2020 (%)	Forward PE (x)	Trailing PB (x)	Dividend Yield (%) 2021f	EPS Growth (%) 2021f	EPS Growth (%) 2022f	ROE (%) 2021f
Developed	US	-1.0	-1.0	23.3	4.5	1.9	21.3	15.3	25.5
	Japan	0.4	0.4	18.2	1.5	2.0	-3.4	36.5	7.9
	Eurozone	-1.4	-1.4	17.5	1.7	2.3	48.1	19.0	6.9
	UK	-0.7	-0.7	14.1	1.7	3.8	46.8	14.0	6.2
	Asia Ex-Japan	4.0	4.0	17.5	2.2	2.0	26.2	17.3	10.4
North Asia	China	7.3	7.3	17.1	2.6	2.0	18.3	17.8	10.1
	Hong Kong	2.0	2.0	18.1	1.4	2.6	31.8	12.0	8.8
	South Korea	3.6	3.6	14.7	1.5	1.5	45.7	22.4	12.3
	Taiwan	6.2	6.2	19.6	3.0	2.4	14.4	12.3	16.9
South Asia	India	-2.5	-2.5	23.8	3.8	1.2	36.7	18.6	9.4
	Indonesia	-2.9	-2.9	17.5	2.6	2.9	32.3	20.8	14.6
	Malaysia	-3.7	-3.7	14.5	1.7	3.0	65.5	-5.0	11.2
	Philippines	-7.9	-7.9	18.8	2.0	1.5	43.6	22.7	8.6
	Singapore	1.3	1.3	15.0	1.2	3.7	47.9	18.4	6.5
	Thailand	0.0	0.0	19.9	1.9	2.7	31.5	21.0	7.8

Source: MSCI indices in local currency terms, Bloomberg, Datastream, BNP Paribas (WM), as of 31 January 2021

Fixed Income

POSITIVE NEUTRAL NEGATIVE

OVERALL GLOBAL: NEGATIVE		
Positive	Neutral	Negative
Short-term UST Invest. Grade EMD (LC) EMD (HC)	High Yield	Long-term UST German govies

OVERALL ASIA (USD): NEUTRAL		
Positive	Neutral	Negative
Hong Kong Singapore	India Philippines South Korea Indonesia China	-

		Total Return (%)			Yield-to-Worst (%)
		1-Month	2020	2019	
Asia	Asia USD Bond	-0.2	7.1	7.3	2.5
	Asia Local Currency Bond	-1.2	7.9	9.2	2.7
	China	-0.2	5.9	6.1	3.1
	Hong Kong	0.1	8.0	8.0	2.1
	India	0.3	7.0	6.7	3.2
	Indonesia	-0.3	9.5	9.8	2.6
	Singapore	-0.2	6.8	6.9	1.8
	South Korea	0.2	7.1	6.9	1.0
	Philippines	-0.3	7.1	7.4	2.2
Other Regions	US 10-year Treasuries	-0.8	7.8	8.7	1.1
	US Investment Grades (IG)	-0.7	6.7	7.5	1.2
	US High Yield (HY)	0.3	7.5	7.1	4.3
	Emerging Market USD Bond	-0.1	6.7	6.8	3.3

Source: Barclays indices, Bloomberg, BNP Paribas (WM) as of 31 January 2021

US Treasury 12-month Yield Targets (%)	2Y	5Y	10Y	30Y
	0.25	0.50	1.40	1.90

- **Real yield remains low:** Both the Fed and the ECB have no intention to raise their policy rates. They want to maintain real yield low to support the economic recovery. The debate about tapering at the Fed is premature.

- **Positive on Asia/EM hard and local currency bonds:** The global backdrop remain supportive amid the weaker dollar trend and supportive financial conditions.

- **Positive on US Investment Grade (IG) and fallen angels corporate bonds:** IG bonds should remain in demand in 2021 despite higher risks than before if bond yields rise too much. Spreads are low but could move tighter. The low level of spread makes the High Yield (HY) asset class less attractive. We prefer fallen angels as they offer decent yield for lower risk compared to HY.

Forex & Commodities

POSITIVE NEUTRAL NEGATIVE

12-MONTH FOREX VIEW

Positive	Neutral	Negative
JPY EUR GBP AUD NZD CAD KRW MYR SGD	CNY HKD TWD IDR PHP THB	USD INR

COMMODITIES

Positive	Neutral	Negative
Gold, Oil Base metal	-	-

EUR: The worsening of the sanitary situation in Eurozone forced governments to take tougher measures and the dollar took advantage of it in January. We maintain our short-term view of a stabilisation of the EURUSD around 1.20. Nevertheless, market sentiment will become more sensitive to the speed of the vaccination campaigns which is expected to speed up exponentially in Eurozone. **Our 12-month EURUSD target remains 1.25.**

GOLD: Ultra accommodative monetary policies are expected to last for longer. Negative real interest rates and inflation fears should bring back **gold prices above $2000 in 2021.**

OIL: OPEC+ production restraints, in particular the decision of Saudi Arabia to reduce its production in Feb and March by 1mb/d should support prices in the period affected by low demand induced by the covid resurgence. **We expect Brent prices to trade in the $45-55 range in H1 and $50-60 in H2.**

Forex Forecasts

		Spot	3-month		12-month	
		As of 31 Jan 2021	View	Target	View	Target
Developed	USD Index*	90.58	=	91.5	=	88.2
	Japan	104.7	=	104	+	102
	Eurozone	1.215	=	1.20	+	1.25
	UK	1.373	=	1.36	+	1.45
	Australia	0.767	=	0.76	+	0.80
	New Zealand	0.717	=	0.72	+	0.75
	Canada	1.277	=	1.27	+	1.25
Asia Ex-Japan	China	6.461	=	6.50	=	6.40
	Hong Kong*	7.754	=	7.75	=	7.75
	South Korea*	1,119	=	1,085	+	1,065
	Taiwan*	28.00	=	28.2	=	27.7
	India	72.96	-	75.0	-	75.0
	Indonesia*	14,030	=	13,800	=	13,800
	Malaysia*	4.043	=	3.98	+	3.87
	Philippines*	48.08	=	47.4	=	47.5
	Singapore*	1.327	=	1.30	+	1.27
	Thailand*	29.93	=	30.60	=	30.30

Source: BNP Paribas (WM) as of 31 January 2021
**BNP Paribas Global Markets forecast as of 31 January 2021*

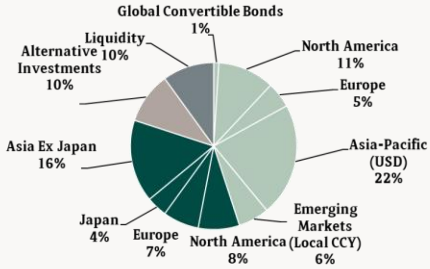
Note: + Positve / = Neutral / - Negative

Strategic & Tactical Asset Allocation

OUR TACTICAL ASSET ALLOCATION IS BASED ON OUR CIO'S ASSET ALLOCATION VIEWS. THERE ARE NO CHANGES THIS MONTH.

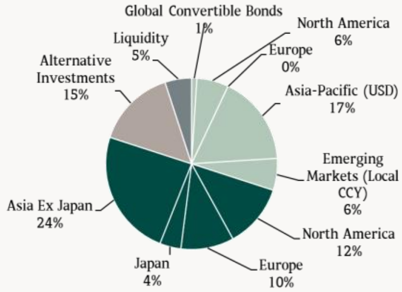
INVESTMENT PROFILE: BALANCED

	STRATEGIC ASSET ALLOCATION		TACTICAL POSITIONING		THIS MONTH'S TACTICAL ASSET ALLOCATION
FIXED INCOME	50%	+	-5%	→	45%
EQUITIES	30%		5%		35%
ALTERNATIVES	10%		-		10%
LIQUIDITY	10%		-		10%



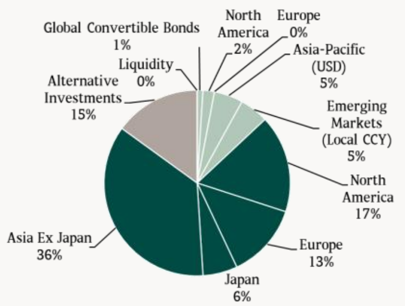
INVESTMENT PROFILE: DYNAMIC

	STRATEGIC ASSET ALLOCATION		TACTICAL POSITIONING		THIS MONTH'S TACTICAL ASSET ALLOCATION
FIXED INCOME	35%	+	-5%	→	30%
EQUITIES	45%		5%		50%
ALTERNATIVES	15%		-		15%
LIQUIDITY	5%		-		5%



INVESTMENT PROFILE: VERY DYNAMIC

	STRATEGIC ASSET ALLOCATION		TACTICAL POSITIONING		THIS MONTH'S TACTICAL ASSET ALLOCATION
FIXED INCOME	20%	+	-7%	→	13%
EQUITIES	65%		7%		72%
ALTERNATIVES	15%		-		15%
LIQUIDITY	0%		-		0%



Source: MyAdvisory, as of 2 February 2021
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