華夏基金(香港)
ChinaAMC (HK)

2022 Mid-Year Market Outlook

Contents

Letter to Investors

Dear Investors,

The first half of 2022 would surely go down in history. The abrupt escalation of the conflict between Russia and Ukraine, along with the rapid worsening of the pandemic in the mainland of China, have added to the turbulence in the global financial markets. With high inflation already a headache for many overseas economies, the pace of monetary tightening in developed markets has exceeded market expectations. All these surprises have cast a shadow on the prospects of global economic growth and stirred up enormous volatility in financial markets.

Early this year, the Chinese stock market had at one point led the gains amongst major global indexes, as it benefited from the expectations of economic recovery supported by Beijing's emphasis on stable growth. Yet the combination of the Russia-Ukraine crisis and a new COVID wave in China fueled worries about the growth outlook and the potential impact of geopolitical tensions. In mid-to-late February, the Chinese stock market started to experience wide swings, prompted by both domestic and external factors. At the same time, it also showed exceptional resilience thanks to Chinese stocks' low valuation and the government's introduction of growth-stabilizing policies. The market witnessed rounds of sharp rebounds that often followed deep corrections. Making investments has become more challenging amid market swings. However, our equity team has managed to navigate the turbulence with diligence and rich professional investment experience, while laying the groundwork for even better investment returns in the second half of 2022.

As the top Gray Rhino of the year so far, inflation has risen rapidly as energy and other commodities come under supply pressures. The central banks of developed countries are no longer "playing nice," but instead speeding up their rate hikes. With the exception of some emerging markets, the rising yields of sovereign bonds and the widening spread have caused severe plunges in the global bond markets in the first half. In response, we have adopted a more defensive strategy for our fixed-income funds in terms of duration and credit rating. The strategy has so far been proven to be successful, generating higher returns than relevant benchmark indices.

Looking ahead to the second half , the confluence of rising inflation and tightening cycles in overseas economies are set to weigh on global financial markets. On the other hand, China is expected to regain its growth momentum as the domestic pandemic situation improves. Moreover, there is also a notable effort to intensify policy support for economic stability in China, and the impact will be seen and felt, especially when the pandemic eases. We believe that the trough of growth and the worst of this year's selloff are over. As China's economy recovers in the second half, the onshore stock market will garner renewed strength to weather external shocks. In summary, we remain optimistic about China's stock market in the coming six months.

Meanwhile, for overseas bond markets, there are more rattling factors. Major developed countries are facing a real risk of stagflation amid weak supply and demand, as well as a looming economic downturn. Though the Fed has described the economy as "weakening," rather than in a recession, key macroeconomic indicators in the United States, such as retail, services, and housing data will be closely monitored by investors. We maintain a neutral to cautious outlook on the U.S. dollar interest rate duration as interest rates remain volatile and have not shown a trend of steady decline. In terms of the credit market, we prefer short-duration investment-grade bonds.
Last but not least, ESG has become an essential area of focus globally. In the first six months of 2022, we have also invested intensively in ESG-related facilities, both in equities and bonds. We're truly proud that we've now not only incorporated ESG themes into our daily investment decisions but also have made ESG part of our values. With our enhanced ESG investment capabilities, we are well positioned to present you with a new series of ESG products in the second half of 2022 and 2023.

The road ahead is obstacle-packed and long, but we are ready to embark on the next leg of the journey with you. With great developments in the capital markets, we shall reap the rewards of economic growth together.

Best Regards,
China Asset Management (Hong Kong) Limited

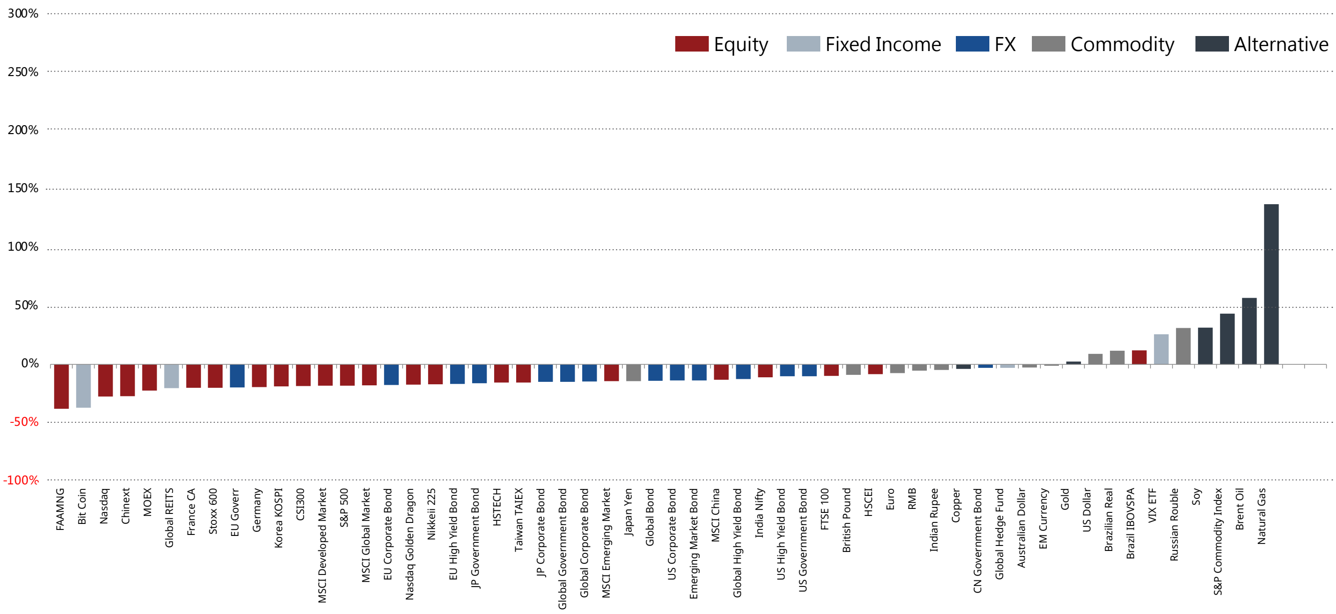
China Equity Market

Raymond JING
Portfolio Manager

Jun ZHANG
Head of Research

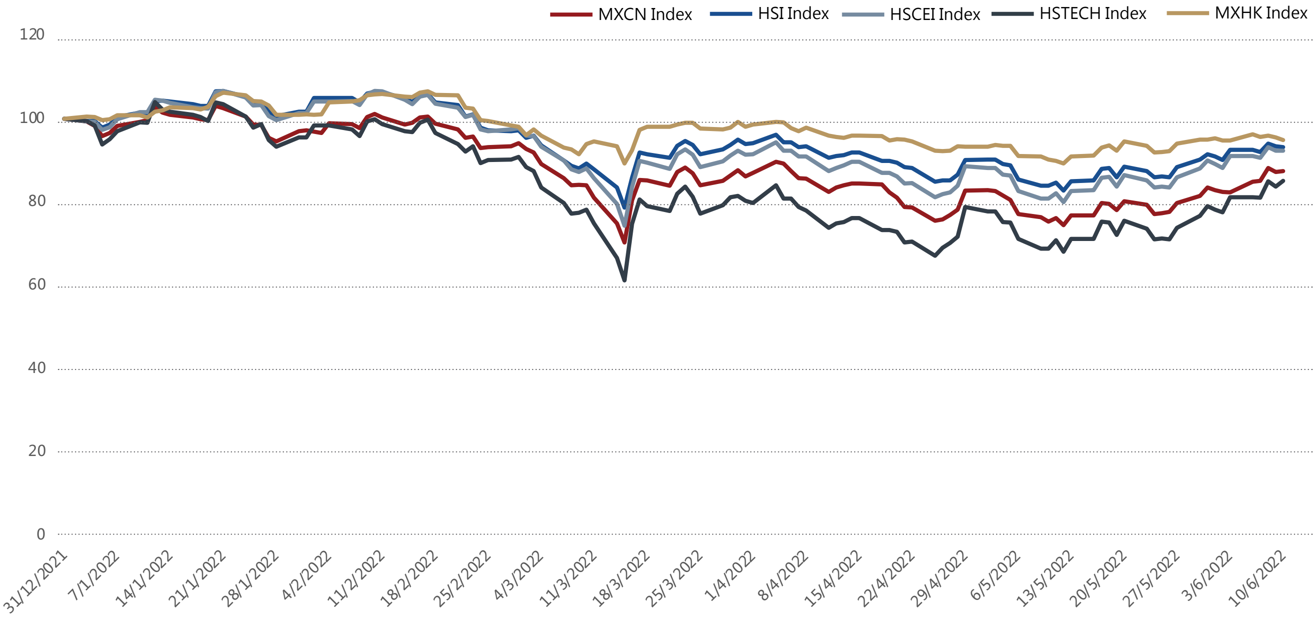
Market Review on the First Half of 2022

Chart 1: Major Assets Performance in 1H 2022
Performance of Major Asset Classes in 2022 (in USD)



Source: Factset, Bloomberg, as of June 10, 2022.

Chart 2: Performance of Offshore China Equity Market in 1H 2022



Source: Bloomberg, as of June 10, 2022.

Five Main Phases in 1H 2022

In the first half of 2022, offshore China equities have outperformed most overseas markets, though they experienced wide-range fluctuations. There are five major phases during the period:

1. Beginning of the year to February 17, 2022: Valuation recovery driven by economic recovery expectations supported by China's pro-growth policies

At the beginning of 2022, the offshore China equity market was among the best performing markets, benefitting from a number of positive factors, including Beijing's supportive policies to stabilize growth and the comparatively low valuations after board corrections. China's January credit data was much stronger than market expectations, leading to the outperformance of high dividend sectors, including energy, financials, infrastructures, and telecommunications.

2. February 18 to March 15, 2022: Sharp market corrections triggered by regulatory risk concern and as Ukraine crisis escalated

As China released the January credit data, growth stocks in new energy, pharmaceuticals, and technology rebounded. In mid-to-late February, the National Development and Reform Commission and other relevant regulators required delivery platforms to lower the standard of service fees for merchants, re-stirring market jitters about regulatory interventions. The surprising escalation of the Russia-Ukraine conflict also triggered concerns over the potential spillover impact on China. Along with a fresh round of COVID in Hong Kong, offshore China equities slumped in the month between mid-to late February and mid-March.

3. March 16 to April 4, 2022: Market Rebound on State Council's response to market concerns

On March 16, Vice Premier Liu He underlined the pledge to stabilize the economy during a meeting of the Financial Stability and Development Committee, including launching pro-growth monetary policies and taking measures to boost the economy, defuse risks in the real estate sector, strengthen the management of major online platforms, cooperate with the U.S regulators on the audit issues of U.S.-listed Chinese companies, and stabilize Hong Kong's financial markets. Thereafter, the Ministry of Finance indicated that there are no suitable conditions this year to expand the list of pilot cities for real estate tax reform. These have restored the confidence of market participants. On March 16, foreign-listed Chinese shares rebounded dramatically. The rising trend continued in the following weeks, as tensions eased between Russia and Ukraine, coupled with positive progress in talks over U.S.-listed Chinese stocks.

4. April 5 to May 12, 2022: Market corrections thanks to COVID outbreaks and China's growth concerns

Since late March, another wave of COVID has spread to multiple provinces in mainland China. The lockdown in Shanghai caused serious concerns over the outlook for China's growth and corporate earnings. The economic data in April hit a record low. Hawkish signals from the Federal Reserve have also resulted in the depreciation of the RMB. Offshore China equities began to fluctuate downward and experienced a temporary rally on April 29, driven by the Politburo's confirmation to ramp up supportive measures. The meeting vowed to "strengthen macro adjustments and strive to achieve full year economic and social development goals," "complete the rectifications of the platform economy and unveil specific measures to support its regulated and healthy development," and "timely respond to market concerns, maintaining stability in the capital market." Yet, Beijing stepped up COVID prevention and control measures in early May, and Politburo's Standing Committee reaffirmed the "dynamic zero" policy, generating renewed concerns over the economic growth. Meanwhile, the deep corrections in overseas markets have also contributed to the collapse of the offshore China equity market.

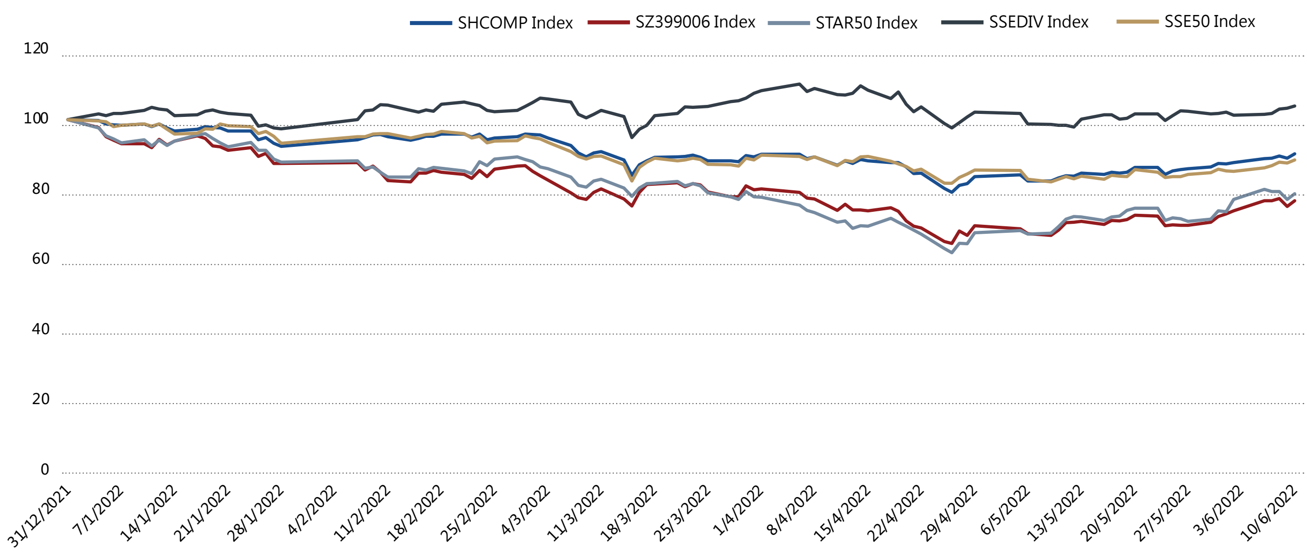
Chart 3: The Number of Newly Confirmed Cases in China and the GDP Share of Cities with Newly Confirmed Cases

Source: Wind, as of June 12, 2022.

5. Since May 13, 2022: Market rebound fueled by renewed optimism as pandemic significantly eases and more growth measures launch

In mid-May, the number of newly confirmed and asymptomatic cases dropped to below 2,000 in the mainland of China. Shanghai has basically achieved dynamic zero. Trade and industry resumed, and the lockdown was lifted on June 1, 2022. The situation in Beijing was also under control. The impact of the pandemic on economic activity has largely diminished, and high-frequency economic data showed marginal improvement. There was a clear uplift in the market sentiment. At the same time, the People's Bank of China cut the 5-year Loan Prime Rate (LPR) by 15bp to encourage demand for mid-to-long-term loans and guide financial institutions to increase credit supply. During a national teleconference, the State Council also sent a clear message on maintaining stable growth. Tax breaks and consumption subsidies were provided for car and mobile phone purchases across China to stimulate domestic demand. The offshore China equity market has rebounded sharply since mid-May and led other major markets on signs of support for platform enterprises and the better-than-expected Q1 earnings of many Internet giants.

Chart 4: Performance of China A-Share Market, 1H 2022



Source: Bloomberg, as of June 10, 2022.

Overall, A-shares exhibited a similar trend to offshore China equities in the first half of 2022, being influenced primarily by macroeconomic factors, particularly the COVID outbreak in the mainland and stricter policies to control the pandemic. External shocks, on the other hand, only had a modest impact. Growth stocks made a comeback after the Politburo meeting at the end of April, with the SSE Science and Technology Innovation Board 50 Index taking the lead. Compared to offshore China equities, they are also less affected by the selloff in the overseas markets in early May.

Amidst the market turmoil this year, high-dividend value stocks, such as the SSE Dividend Index, have outperformed growth stocks. Value stocks in energy, infrastructures, financials, and nonferrous metals have taken the lead in the first half of 2022. While growth sectors, including electronics, IT, media, and defense, have lagged in their performance over the same period. New energy and electronic vehicles also climbed higher by the end of April, fueled by improved growth prospects and the continuous introduction of supportive policies.

Overall, against the backdrop of stable domestic growth and rising interest rates overseas, the Chinese stock market has experienced wide-range fluctuations in the first half of 2022. Value stocks have outperformed growth stocks most of the time. Although we have become better prepared for the market fluctuations caused by tensions in the Sino-U.S. relationship, the conflict between Russia and Ukraine and waves of COVID outbreaks in China have caught the market off guard. As the Chinese stock market recovers from the short-term domestic and external shocks in the first six months of 2022, it is poised to benefit from relatively low valuations and the continuous roll-out of pro-growth measures. Valuations are expected to be recovered significantly, reflecting the strong resilience of the market.

Key Factors Influencing the Markets in 2H 2022

The Pandemic Situation and Anti-Epidemic Measures Being the Determinants

The spike in COVID cases in China was the most impactful internal factor in the first half of 2022. The high transmissibility of the Omicron variant has presented tremendous challenges to China, in spite of its successful implementation of the "dynamic zero" policy in the past two years. The outbreak in Shanghai and its impact on growth was especially worrisome for investors. The short-term fundamentals of the Chinese economy have turned relatively weak. Furthermore, the continuous tightening of monetary policies in developed countries will cause the yuan to depreciate in the short term. As China implements regular nucleic acid testing in many cities to improve the effectiveness and timeliness of anti-epidemic measures, the probability of large-scale outbreaks similar to Shanghai in other domestic regions is lower. However, we expect to see sporadic outbreaks in the mainland of China, which will continue to cast uncertainties upon China's economy.

We expect China will hold firm on its "dynamic zero" policy in the foreseeable future. The government will make up the anti-epidemic "toolbox" by pushing for a higher vaccination rate (especially for the elderly, who tend to have a lower vaccination rate now), encouraging mixed vaccination, speeding up the development of oral antiviral drugs, instituting the "15-minute community testing spots" and enhancing the availability of mobile cabin hospitals nationally. These steps will pave the way for the eventual relaxation of pandemic policies and enable China's post-pandemic reopening. We will be paying close attention to the policy pronouncements emanating from the Beidaihe Summer Summit and the 20th National Congress of the Communist Party of China, both of which will be held in the second half of 2022. Over time, we expect the impact of the pandemic on China's economy will gradually wane, while overseas investors will express stronger interest in China's stock market.

The Extent and Rhythm of the Next Rally Hinge on Stabilization Policies and Pace of Recovery

China has entered into a new easing cycle since 4Q 2021, but the tightening of anti-epidemic measures had an enormous adverse impact on China's economic growth and corporate earnings in 2Q 2022. Since the latter half of May, the pandemic situation has improved. Trade and industry resumed, and there was a notable improvement in China's high-frequency economic data. Along with the implementation of aggressive policies to promote stable growth, the PMI, trade, and credit data all beat market expectations in May. However, the domestic demand for financing in the real economy remains relatively weak and awaits further recovery. The drop in overseas demand will also dampen the prospect of export growth.

Driven by the favorable factors above, as well as the positive signals in the regulation of Internet companies, China's stock market has outperformed other major indexes in the world since the Politburo meeting in late April. Investors have shown better sentiments toward China's economic recovery after the pandemic situation improved. As of now, China's stock market has recovered the lost ground caused by the new COVID outbreaks and the subsequent tightening of anti-epidemic policies. Market valuations rebounded from their extremely low levels earlier. For the stock market to rise further, it takes not only the marginal improvements in the economic data in April, but further improved demand for financing in the real economy and a revival of domestic consumption. The rising trend may lose momentum if the pace of economic recovery does not meet expectations. We remain cautiously optimistic about China's economic recovery in the latter half of 2022, given that the Chinese government has shown both determination and the remarkable ability to implement policies to stabilize growth.

Potential Disruptions from Overseas Policies, Market Trends, and Uncertainties in Geopolitical Risks

The U.S.-led overseas markets have begun the interest rate hike cycle in 2022. Unexpected tensions between Russia and Ukraine have caused commodity prices to surge, which has affected global capital flows by pushing up the U.S. Dollar Index and the U.S. Treasury yield. As a result, the global economy has slowed, financial markets around the world have plummeted, and the Chinese stock market may be disrupted. In May, the United States Consumer Price Index (CPI) grew 8.6% year over year. Market expectations for the Fed's rate hike have risen to the highest level in this cycle. In June, the University of Michigan Consumer Sentiment for the U.S. fell to 50.2, a historic low and far below market expectations. This is evidence that runaway inflation has adversely impacted the expected purchasing power of U.S. consumers and general consumer sentiments. Furthermore, the European Central Bank (ECB) has raised its inflation projections for June, showing a more hawkish stance than expected.

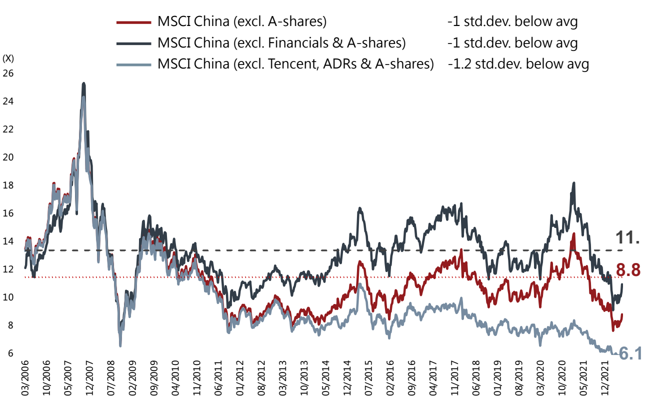
Prolonged high inflation, policy-tightening headwinds on stock valuations, and worries about recession will present shocks to overseas financial markets. Although valuations of U.S. equities have dropped significantly from late-2021 levels after the drastic corrections since early 2022, downward revisions of earnings guidance by U.S. corporations are expected to result in high volatility in the market.

There are still looming uncertainties, such as the conflict between Russia and Ukraine, the Sino-U.S. relationship, and other geopolitical risks. While we expect the chances of new tensions flaring up in the Sino-U.S. relationship in the short term to remain low, there is also limited room for further compromise, given that both countries will undergo significant political events in the latter half. Developments in the Sino-U.S. relationship will continue to impact the Chinese stock market in the medium-to-long term. Finally, whether the U.S. Congress will pass the Accelerating Holding Foreign Companies Accountable Act, and how and if China and the United States resolve differences on the auditing issues for U.S.-listed Chinese companies will have a direct impact on the performance of offshore Chinese equities.

2022 Mid-Year Outlook and Allocation Strategy

Cautious Optimism for China's Stock Market in the Second Half of 2022

Chart 5: MSCI China Index Forward P/E



Source: Factset, Bloomberg, as of June 13, 2022.

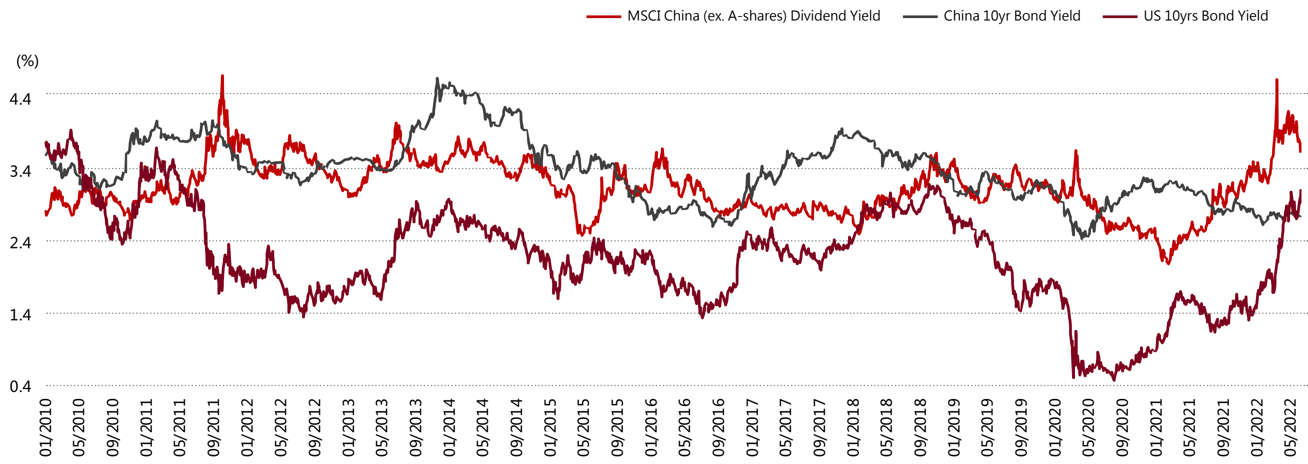
Chart 6: : MSCI China Index Equity Risk Premium (ERP)

Source: Factset, Bloomberg, as of June 13, 2022.

Offshore China Equity Market Has More Upside Potential, Though More Vulnerable to External Disruptions

Since the rebound in May, offshore China equities have recovered from extremely low levels, but valuations remain at historical lows. The dividend yield of the MSCI China Index (excluding A-shares) reaches 3.7%, quite a notch higher than the 2.8% yield of the China 10Year Government Bond. We believe valuations have already bottomed, given that the negative external conditions that shook the offshore China equities in the first half have improved significantly. Markets should show a volatile uptrend going forward, with its rhythm being influenced by China's economic recovery and developments overseas.

Chart 7: MSCI China Index (Excluding A-shares) Dividend Yield



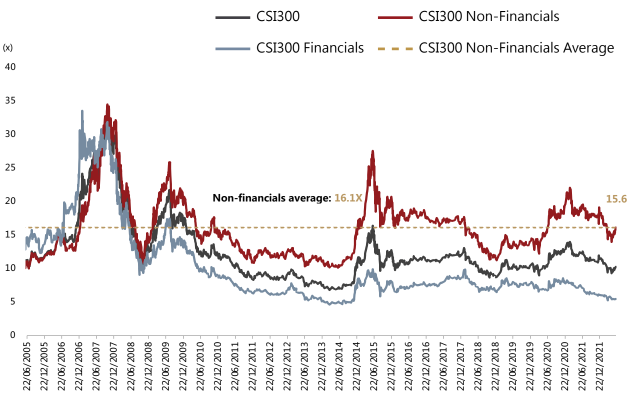
Source: Factset, Bloomberg, as of June 13, 2022.

After a year of corrections, investors' current positions in offshore China equities are at a comparatively low level. The market has fully priced in relevant risks now. The regulatory direction of previously heavily regulated industries, like the internet and real estate industries, has taken a clear turn. As such, relevant industries should be on course for a period of growth. Meanwhile, the market has also adjusted its earnings forecasts to a reasonable level. COVID-impacted second-quarter earnings should be the lowest point in the foreseeable future. We expect investors to increase holdings of offshore China equities on the improvement of the pandemic situation, a relaxation of regulatory policies, and the continuous implementation of stabilization policies. If China is able to complete the preparation of its anti-epidemic toolbox in 4Q 2022 and releases a clearer signal to relax its pandemic prevention and control measures, investors would soon be increasing their positions, thus driving valuations higher.

Although we are optimistic about the earnings and valuation recovery of the offshore China equity market in the second half of 2022, external uncertainties will weigh on the market's potential upside. We will be especially mindful of the regulatory developments in U.S.-listed Chinese stocks, the pace of economic recovery in China, new stabilization policies, and further expansion of the Stock Connect Program.

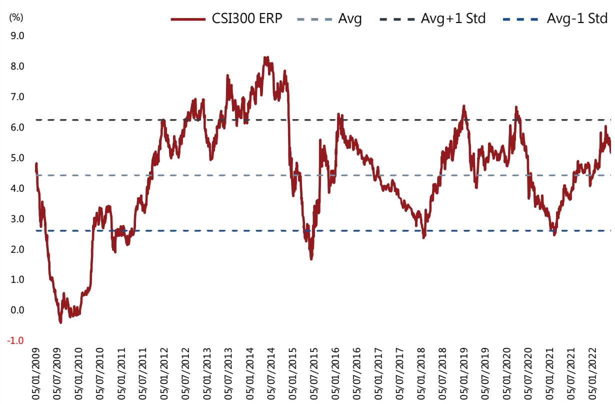
China's A-share Market Valuations are at a Reasonably Low Level; Industry Distribution Complements China's Development in the Medium-to-Long Term

Chart 8: CSI 300 Forward P/E



Source: Factset, Bloomberg, as of June 10, 2022.

Chart 9: CSI 300 Equity Risk Premium (ERP)



Source: Factset, Bloomberg, as of June 10, 2022.

A-share trends have not been as prone to external shocks. The current valuation of the A-share market is at a reasonable low level, but not as low as that of the foreign-listed Chinese shares. The overall institutional investment position of A-shares remains at a relatively high level, primarily concentrating on a few popular sectors. After more than a month of a sharp rebound, growth sectors like new energy and electric vehicles have limited upside potential going forward. Generally speaking, the A-share market is more resilient to external shocks than foreign-listed Chinese shares in the short term. Yet its upside is also limited in comparison.

In the medium-to-long term, the A-share market tends to comport better with China's developmental goals due to a large number of listed companies in advanced manufacturing industries, such as new energy and semiconductors. It will present ample investment opportunities as the emerging industries further develop. In the relatively short term (2H 2022), stable growth remains the top priority in China. The traditional value sector may benefit more than the advanced manufacturing sector, though the latter remains a high-prosperity sector. Investors' better-informed expectations and a comparatively high position in the sector will limit the short-term upside. In comparison with the offshore China equities, the drives for the A-share market in the second half of 2022 are relatively limited.

Allocation Strategy: A Balanced Approach across Sectors and Themes in the Second Half of 2022

Since the beginning of 2022, high-dividend names led by energy, telecommunications and financials have outperformed the growth names. This is in line with our investment outlook released in early 2022. As overseas markets undergo the rate hike cycle, with inflation hovering at high levels, we will probably continue to see high volatility in the second half. This is a factor that will continue to disrupt China's stock market. At the same time, China will implement more policies to stabilize growth, and monetary easing is expected to be more effective once the pandemic is under control. We believe that the value sector will remain a defensive option for investors and the main beneficiary of stabilization policies, which will continue to provide solid absolute returns in the second half of 2022, given their attractive valuations.

The valuations of most industries in the growth sector have already reached their historic lows after significant corrections in the first half of 2022. The COVID-impacted second-quarter earnings have indirectly induced downward adjustments in earnings forecasts to reasonable levels. Investors have fully priced in the low earnings in Q2. Due to a low base, there is a good chance of a strong comeback on both month-on-month and year-over-year bases. In the latest market rally, offshore China equities, like internet companies, have outperformed the overall market as investors increased long positions and closed short positions. We expect the upward trajectory to gain further momentum in the second half as uncertainties in earnings and policy risks affecting these growth sectors subside. The growth names in pharmaceuticals, led by biopharmaceutical and medical devices companies, have also seen a full downward revision of their stock prices and valuations. We believe the time has come for medium-to-long-term investments in industry leaders that have a robust outlook. As a high-prosperity sector, advanced manufacturing industries like new energy and electric vehicles have limited upside potential as market expectations and investors' positions are at a high level already, but a deep correction will present a good entry point. On the other hand, electronics and relevant industries remain on a downward trend due to the lower-than-expected sales volume of mobile phones and computers, though stock prices and valuations have both plummeted to historic lows. Better investment opportunities will come only when there are clearer signs of industry recovery.

On thematic investments, we favor industries that will benefit from post-pandemic re-opening, including tourism, hotels, airlines, dining, and retail. With the pandemic situation improving in the mainland of China and the enhancement of the anti-epidemic toolbox, we expect to see a relaxation of pandemic prevention and control measures, with a recovery in corporate earnings on the horizon. Bearing in mind that the balance sheets of some companies in these industries have suffered during the pandemic, we suggest investors screen opportunities with a bottom-up approach. Furthermore, as China wraps ups its three-year action plan to reform state-owned enterprises (SOEs), industry consolidations in the form of mergers and acquisitions, mixed-ownership reforms, and incentive mechanisms, will accelerate, thereby presenting huge investment opportunities. That said, we recommend investors participate cautiously by investing in thematic investment products as seizing such opportunities may not be easy.

Global Fixed Income Market

Serene CAI
Portfolio Manager

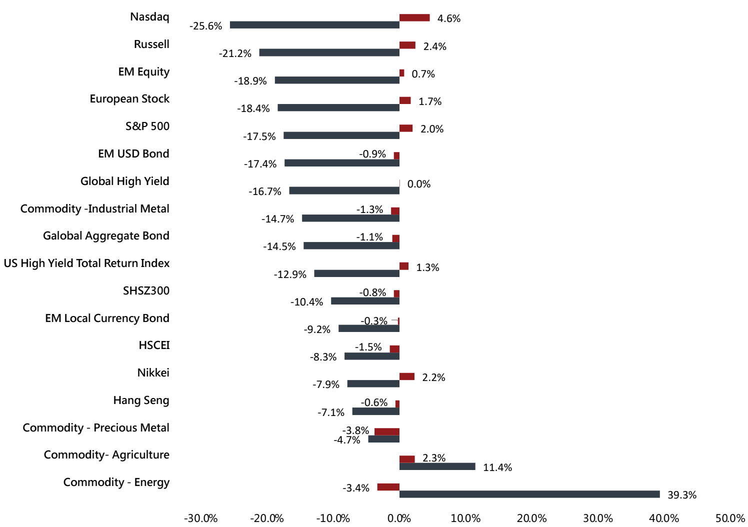
Ziyun WANG
Portfolio Manager

Market Review on the First Half of 2022

Most financial assets have stumbled in the first half of 2022. The Federal Reserve's original plans for gradual rate hikes and mild liquidity tightening, which needed to be supported by a recovery of supply and demand for goods and services, were interrupted by the Russia-Ukraine conflict and a higher-than-expected inflation rate. In our investment outlook for late 2021, we expected a base scenario of rising U.S. dollar interest rates and spreads widening at the same time. Now, the macroeconomic outlook and asset prices are heading towards stagflation. As U.S. inflation hits a 40-year high, both the Biden administration and the Federal Reserve are under enormous pressure.

Physical assets have generally outperformed financial assets in this backdrop. Ukraine-related sanctions have resulted in supply shortages in commodities, especially energy. This sector continued with its upward trend last year, generating remarkably higher returns than other asset classes. As to financial assets, the central banks of the G7 nations have begun the normalization of monetary policies, speeding up the rise in nominal interest rates. Financial assets, be they safer assets such as the U.S. Treasuries and investment-grade bonds of developed nations, or riskier assets such as U.S. equities and emerging market stocks, have all tumbled significantly. The negative correlation between equities and bonds in developed countries was broken. Between the beginning of 2022 and now, the Bloomberg Barclays Global Aggregate Bond Index recorded a total return of -15.74%, indicating a weakening of liquidity amidst the effects of other macroeconomic shocks to the market.

Chart 10: Returns of Major Asset Classes since the Beginning of 2022



Source: China AMC, Bloomberg, as of June14, 2022.

Global Fixed Income Assets Performance

1. FX Market - Emerging market commodity exporters' currencies, such as the Russian ruble, the Brazilian real, and the Peru sol, have outperformed safe-haven currencies like the Swiss franc and the Japanese yen. The U.S. dollar, with the most aggressive interest rate hike path and balance sheet shrinking, has appreciated against other developed-market currencies.

2. Interest Rate Markets - Sovereign bond yields across the maturity spectrum issued by major developed countries are rapidly rising. The U.S. Treasury yield curve is steeper than that of European sovereign bonds. The yields on U.S. Treasuries maturing in one to three years, which are more sensitive to interest rate hikes, increased the most, leading to a yield curve inversion. This indicates a tightening of short-term liquidity as well as increasing worries about long-term growth prospects, both pointing to stagflation.

3. The U.S. Dollar Credit Bond Market - Risk-adverse sentiments have pushed for a downward revision of the spread of USD credit bonds from its relative highs of late 2021. The spread of the U.S. High-Yield Bond Index has risen from 317bps to 487bps, while the spread of the Investment Grade Corporate Bond Index has risen from 89bps to 146bps. Both have widened from the narrowest point in the past five years to a wider point. The double whammy of interest rates and spreads has caused a significant decline in total returns.

Chart 11: Performance of Sovereign Bonds

US	Current%	YTD Change bps	52W Low%	52W High%
2Y	3.41	268	0.15	3.42
5Y	3.52	226	0.60	3.58
7Y	3.48	204	0.89	3.54
10Y	3.38	187	1.13	3.44
30Y	3.35	145	1.66	3.41

China	Current%	YTD Change bps	52W Low%	52W High%
2Y	2.37	-8	2.18	2.86
5Y	3.59	1	2.34	3.03
7Y	2.81	0	2.61	3.16
10Y	2.82	4	2.68	3.18
30Y	3.28	-5	3.22	3.80

Germany	Current%	YTD CHG bps	52W Low%	52W High%
2Y	1.15	177	-0.79	1.17
5Y	1.49	194	-0.78	1.51
7Y	1.53	188	-1.15	1.54
10Y	1.63	181	-0.52	1.63
30Y	1.72	152	-0.13	1.72

UK	Current%	YTD變動bps	52W Low%	52W High%
2Y	2.12	143	0.03	2.15
5Y	2.23	141	0.20	2.23
7Y	2.39	160	0.33	2.40
10Y	2.53	156	0.48	2.54
30Y	2.64	152	0.76	2.65

Source: China AMC, Bloomberg, as of June 14, 2022.

Chart 12: Performance of Different Bond Indexes

Sector Index	2019	2020	2021	2022 YTD Return
USD GS 3M Money Market	2.4%	0.7%	0.2%	0.3%
US Treasury	7.0%	8.2%	-2.4%	-8.7%
Treasuries	5.6%	9.5%	-6.6%	-11.5%
US Corp	14.2%	9.8%	-1.0%	-13.2%
US High Yield	14.4%	6.2%	5.4%	-10.6%
Asian USD	12.0%	7.1%	-3.1%	-10.4%
Asian USDInvestGradeCorp	11.0%	7.3%	0.0%	-8.3%
Asian USD HY Corp	14.4%	8.8%	-19.7%	-18.9%
Asian $ IG Corp	10.5%	6.6%	-0.2%	-7.5%
Asian USD HY Corp China	14.5%	9.4%	-33.3%	-28.4%
iBx $AxJ CN RE HY US TR	14.9%	8.7%	-37.2%	-31.2%
BBB & Lower Asia Soverei	16.1%	5.2%	0.2%	-14.8%
Single A Asian Dol	10.0%	7.7%	-0.9%	-8.2%
BBB Asian Dollar Investm	13.4%	7.5%	0.8%	-9.5%
BB Asian Dollar High Yie	13.8%	6.5%	-5.3%	-13.0%
B Asian Dollar High Yiel	15.0%	10.7%	-34.7%	-26.3%
AsianUSDHYCorp Constrain	14.7%	8.8%	-18.3%	-19.3%
Latin America US Emergin	14.0%	8.1%	0.2%	-11.0%
EMEA US Emerging Markets	14.2%	7.5%	1.7%	-21.3%
High Grade EMEA Emerging	11.4%	7.9%	-0.9%	-25.0%
High Grade Latin America	15.9%	5.4%	-1.3%	-13.8%
High Yield EMEA Emerging	14.7%	9.0%	1.9%	-20.5%
High Yield Latin America	12.2%	9.0%	1.4%	-9.2%
Contingent Cap	17.4%	10.2%	2.2%	-12.5%
US Dollar 2L PR	12.3%	5.7%	-4.0%	-13.6%

Source: China AMC, Bloomberg, as of June 14, 2022.

Macro Environment

The U.S. economy remains strong based on the Q1 data and recent macro indicators. A widening trade deficit reflects a surge in domestic demand. The labor market has recovered in general, but the mismatch issue persists, which could, in turn, push the inflation rate higher if it is not addressed properly. Hot inflation has also exerted pressure on consumer sentiments, contributing to a negative impact on demand. However, recent inventory indexes show that the supply-chain bottlenecks have eased. There are still uncertainties surrounding future changes in inflation in the second half without a single indicator that points to a persistently high inflation rate or an acceleration in the rate of inflation. Changes in both supply and demand may keep inflation at restrained levels. Although there are warning signs in certain current microeconomic indicators, it requires further observation and evidence to conclude whether the U.S. is heading into a recession. We will keep a close eye on the weakening trend in consumer and housing indicators.

In China, the lifting of Shanghai's lockdown and the implementation of stabilization policies have prompted a rebound in short-term macroeconomic data, including imports and exports and financial data. Aggregate financing and government bond financing both climbed year over year in May, bringing a rebound in total social financing and broad money supply (M2). With note financing increasing in the same month, the credit easing policy has created ample liquidity for future growth. While net private financing has not yet recovered, the People's Bank of China may maintain a moderately easy monetary policy while prices are still under control. Meanwhile, we'll continue to see more fiscal policies aimed at stabilizing the economy.

Monetary Policy

The unemployment rate and the development of the service sector in the United States remain robust. By raising interest rates and shrinking its balance sheet, the Fed can suppress demand, thereby reigning in inflation.

Chart 13: Comparison of the Current Rate Hike Cycle with the Last Round

	Last Interest Rate Hike Cycle	Current Interest Rate Hike Cycle
QE Tapering	First came a year of QE tapering. The Fed began to reduce its balance sheet after the balance sheet stopped growing for two years.	There was only a three-month gap between the QE tapering and the beginning of balance sheet reduction.
Interest Rate Hike	There were only two rate hikes in the first two years of the cycle (2015 and 2016). The first hike came more than 1.5 years after the Fed's balance sheet reduction. The rate hike was only 25 bps each for the first two hikes.	This round of interest rate hikes comes only three months after tapering, and the Fed has raised rates at each FOMC meeting. The second rate hike was already at 50 bps.
The Pace of Balance Sheet Reduction	The Fed will reduce its purchases of Treasury securities by US $30 billion as previous holdings mature.	As current holdings mature, the Fed will its purchases of Treasury securities by US $60 billion.
External Environment	As the interest rate hikes and the balance sheet shrinking began, oil prices plummeted, and the European sovereign debt crisis occurred. European countries had to implement easing policies, which offset the effects of the Fed's balance sheet shrinking to some extent.	The Russia-Ukraine conflict has dealt a major shock to supply chains of energy and other commodities, with oil prices soaring.
Duration of the Yield Curve Inversion	In the last three cycles of monetary tightening, the yield curve inversion typically lasted between one and eight months.	Investors have priced in more aggressive rate hikes, and the magnitude of the first few rate hikes has surpassed that of the hikes in previous cycles. This will lead to a higher chance of a flat or inverted yield curve. The ultimate duration will be determined by the macro trends in the U.S. when interest rate hikes are over.

Credit Bonds

With effects on funding costs, interest rate curves, and liquidity, monetary tightening will have a negative impact on global credit bond markets. For corporations, the costs of both issuing new bonds and paying off existing debts have risen in this rate hike cycle, and the duration of newly issued bonds is shortening. Thus, market participants tend to be cautious about the current liquidity and market sentiments.

We believe that there is a real risk of stagflation as prolonged high inflation in developed economies like the United States could put downward pressure on both supply and demand and lead to an economic downturn. The real returns of traditional investment strategies are also under pressure, except for real estate and energy-related assets. With the ongoing normalization of monetary policy globally, weakened liquidity will lead to elevated volatility. As of now, the interest rate hikes have caused disruptions in global financial markets, but the markets are not yet in a state of distress (for example, high yield bonds are still somewhat leading investment-grade bonds). Also, we haven't seen any capital flight from the emerging markets and risky assets, or otherwise any indication of a fundamental change in liquidity.

Therefore, we expect to see the U.S. dollar remain strong relative to the currencies of other developed markets or emerging markets as a result of aggressive rate hikes and the Fed's balance sheet shrinking. The markets will be dominated by risk aversion sentiment and remain highly volatile, with risky assets under pressure before 3Q. The global economy (including both developed economies like Europe and Japan and the emerging market economies) may experience a notable downturn. Capital will continue to flow out of risky assets, emerging markets, Europe, Japan, and back into the United States. The sectors that have done well to this point, such as energy and base metals, may also experience a pullback. As risks related to interest rates and spreads continue to be unwound, we see more value in high-quality short-duration investment-grade bonds.

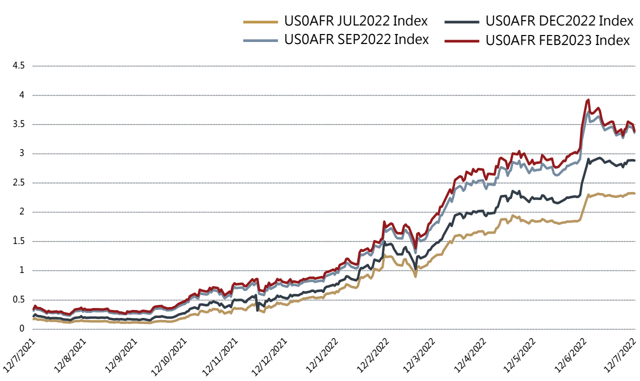
Investment Opportunities and Asset Allocation Strategies

Asset Allocation

Short-duration assets with high credit ratings will be the most preferred safe assets. The short-term interest rate curve is extremely steep as the market has priced in interest rate hikes. Different combinations of spreads, such as the 3m1y, 3m2y, and 1m1y, are all at the steepest point in recent years, or even in terms of a decade. For short-term investors, where the term of the investment allows, a reasonable extension of the duration may offer early access to higher dividend income.

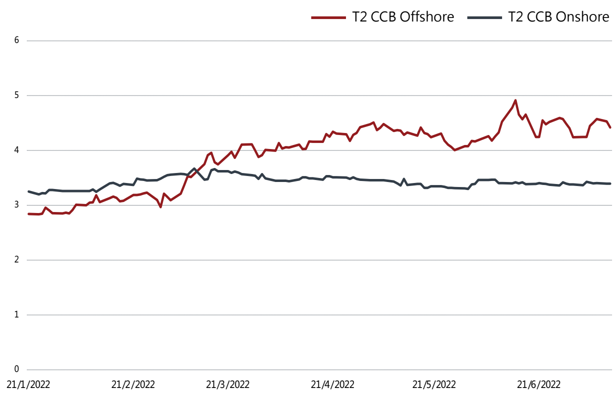
As the Sino-U.S. bond spread further inverts, investing in short-duration investment-grade U.S. bonds will effectively enhance the return of your portfolio while keeping credit risk unchanged.

Chart 14: The trend of Short-term Interest Rate Futures and its implication of rates at FOMC

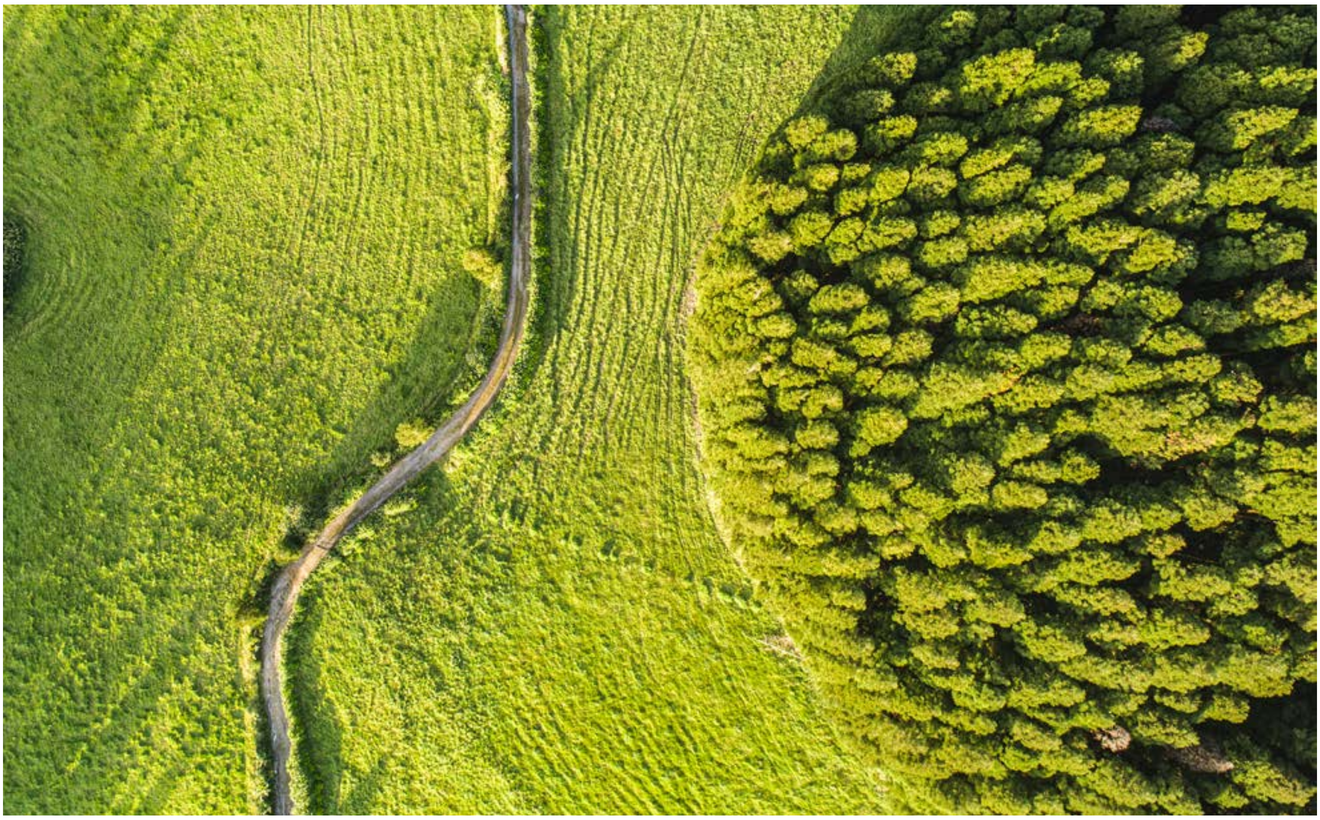


Source: CCB, as of 14 June 2022

Chart 15: Returns of CCB's Tier 2 Capital Bonds, offshore vs onshore



Source: CCB, as of 14 June 2022



Trading Strategy

1. The yield curve will remain relatively flat for a period of time. In general, investors will be cautious in terms of duration, credit ratings, and sovereign issuers. Investment portfolios should be balanced instead of being overly focused on investment return.

Valuation: At the beginning of 2022, valuations of many U.S. dollar credit strategies were at a relatively high level. Presently, these bonds are trading at a wider range of the five-year average. The widening of investment-grade bonds reflects the cautious sentiment in the market. The spread for long-duration credit assets has narrowed relative to short-duration credit assets. The yield curve is flatter, but yet to call an inflection point.

Sectors: Since the beginning of 2022, the spreads in various industries have shown widening trends. The performance of subordinated bonds of financial institutions and bonds issued by companies in the consumer discretionary sector has by far lagged. The spreads of bonds issued by energy companies, which performed relatively well in the first two quarters, have also shown signs of weakness in the past month. Asset prices have pulled back from their highs. Given the unclear macro picture, it is hard to say the widening is enough to compensate for the risk. We prefer robust industries that are less impacted by cyclical changes.

Countries: The combination of the rapid appreciation of the U.S. dollar and risk aversion sentiments has caused capital outflows from risky assets and back into the United States. Emerging markets continued to lag behind developed countries. Countries in Asia were not directly affected by the Russia-Ukraine conflict and the subsequent energy supply cutoff.

Spread: The spreads of investment-grade Asian bonds have widened by 40bps. We prefer those that can benefit from spiraling commodity prices and strong fiscal policies.

2. Investment-grade bonds with longer durations tend to be less volatile in the short term by the measure of unit duration. The current low levels offer investors with a total-return approach an ideal timing for deploying funds in cheap investment-grade bonds with medium to long maturities.

Hit by rate hikes and spread widening, the clean price of many long-duration bonds issued in 2020 and 2021 in terms of 30 years has dropped 20% to 30%, making the dollar price of the bonds has fallen around 70pts. In the current downward cycle, high-yield bond refinancing will become more difficult, resulting in potential defaults or credit downgrades.

The price of investment-grade bonds (rated A or above) that have simpler structures is at a relatively low level, making them an ideal option for a defensive portfolio. We believe that such bonds will benefit from the convexity, buying interest of real money, and the upside resulting from the issuers' debt management in the next interest rate downtrend. We prefer high-quality corporate bonds of developed countries and some quasi-sovereign bonds of emerging markets.

Risk Factors

- The price of resource products far exceeds expectations
- And the economic activities in the United States is at a lower level than expected.

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  New Horizon China A Share Fund

- Asian Bond (3 Years)
  Select Asia Bond Fund Market Awards

Market Awards Best Fund Launch (ETF) - Hong Kong
- Hang Seng Hong Kong Biotech Index ETF

Fund Selector Asia Fund Awards Hong Kong 2022

Regional Bond - Platinum
- Select Asia Bond Fund

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Greater China Equity (1 Year) - 1st Runner-up
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