Market Insights

July 2022

Equity

China equity market significantly outperformed other major equity markets in June, mainly driven by the economic recovery after Shanghai's reopening and relaxation of mobility restrictions at the country level, the continuous pro-growth policies supporting investment and consumption, the abundant liquidity and improved investor sentiment, and more signals on possible reduction of US tariffs over China exports. China equities had considerable competitive advantages over most overseas equity markets, in terms of both economic growth trends and monetary policy directions. China's manufacturing PMI rose to 50.2 in June form 49.6 in May, showing signs of continuous improvement on resumption of production as COVID cases dropped and restrictions eased. We maintain our long-term positive view on China equity market. We expect the divergent monetary policy between the PBoC and the Fed to continue to make China equity market more resilient in the coming months. However, with future pandemic development remaining uncertain and global headwinds strengthening, we will pay close attention to China's subsequent economic recovery process and the volatility of global financial markets.

Market Performance

MSCI China Index went up by 5.73% in the month of June. China equity market significantly outperformed other major equity markets in June, mainly driven by the economic recovery after Shanghai's reopening and relaxation of mobility restrictions at the country level, the continuous pro-growth policies supporting investment and consumption, the abundant liquidity and improved investor sentiment, and more signals on possible reduction of US tariffs over China exports. China equities had considerable competitive advantages over most overseas equity markets, in terms of both economic growth trends and monetary policy directions. Since the latter half of May, the pandemic situation in mainland has improved, trade and industry resumed, and there was notable improvement in China's high frequency economic data. Along with the implementation of aggressive policies to promote stable growth, China's PMI, trade, credit and other macro data in May all showed marked improvement.

Different from major overseas equity markets, growth stocks in China equity market performed much better than value stocks in the midst of the market rally in June. Sector wise, auto, new energy, Internet, consumer services and healthcare led, while energy, materials, banks and utilities lagged. The nationwide consumption stimulus policies, especially in the auto sector, combined with the weakness in commodity prices in recent weeks, helped improve investors' growth expectations on auto and other consumer services sectors. With ample liquidity, more investors started to add growth exposure which benefit more from China's short-term economic recovery after mainland COVID satiation eased. Besides, China cut quarantine time for inbound travellers, shortening centralized quarantine to 7 days from 14 days and monitoring health at home to 3 days from 7days, which was the first such easing since COVID outbreak in early 2020. Also, China's MIIT announced that people's digital travel passes will no longer indicate itinerary to places with domestic Covid-19 cases in the past 14 days. Both moves suggest that China is adjusting its COVID control measures to reduce the impacts on economic growth.

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Equity

Greater China Indices	Jun Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	4485.01	9.62	-9.22	3757.09	5186.66
MSCI China	74.42	5.73	-11.71	58.68	109.62
HSI	21859.79	2.08	-6.57	18235.48	29146.28
HSCEI	7666.88	3.37	-6.91	6051.62	10812.73
Global Indices					
S&P 500	3785.38	-8.39	-20.58	3636.87	4818.62
Dow Jones Industrial Average	30775.43	-6.71	-15.31	29653.29	36952.65
Nasdaq Composite	11028.74	-8.71	-29.51	10565.13	16212.23
FTSE 100	7169.28	-5.76	-2.92	6787.98	7687.27
DAX 30	12783.77	-11.15	-19.52	12438.85	16290.19
Nikkei 225	26393.04	-3.25	-8.33	24681.74	30795.78

Economic Data

China's manufacturing PMI rose to 50.2 in June form 49.6 in May, showing signs of continuous improvement on resumption of production as COVID cases dropped and restrictions eased. Both the output and the new orders sub-index rebounded by over 2ppt in June. The non-manufacturing PMI rebounded sharply to 54.7 in June from 47.8 in May, driven by the recovery of service sectors after the control of the Omicron wave. The construction index rose to 56.6 in June from 52.2 in May, as the supply chain disruptions of raw materials eased.

The broad-based improvement in PMI showed the resumption in economic activity and recovery in business sentiment as the Omicron wave had been well under control and COVID control measures have been relaxed.

Future Outlook

Looking forward, we maintain our long-term positive view on China equity market. President Xi Jinping pledged that China would strengthen the macro-policy adjustment and adopt more effective measures to strive to meet social and economic development targets for 2022. PBoC reiterated supportive monetary policy at the Q2 MPC meeting, and the Q2 statement deleted "maintaining stable macro leverage ratio" which was in the Q1 statement, which suggests policymakers might aim to accelerate credit growth to support economic growth in the near term. We expect the divergent monetary policy between the PBoC and the Fed to continue to make China equity market more resilient in the coming months. However, with future pandemic development remaining uncertain and global headwinds strengthening, we will pay close attention to China's subsequent economic recovery process and the volatility of global financial markets.

In terms of portfolio positioning, we will continue to seek a balance between value and growth, while seek opportunities to increase the portfolio exposure to China's economic recovery and the reopening process. Considering the recent improvement of high frequency property sales data, we will also look out for the potential investment opportunities in the real estate chain companies selectively and prudently.

Risk

Inflationary pressure passed to downstream sectors; foreign monetary policies being tightened due to higher-than-expected inflation; Sino-US relationship worsens than expectation. Russia-Ukraine War worsens than expectation; another wave of local outbreak of COVID-19 in short term.

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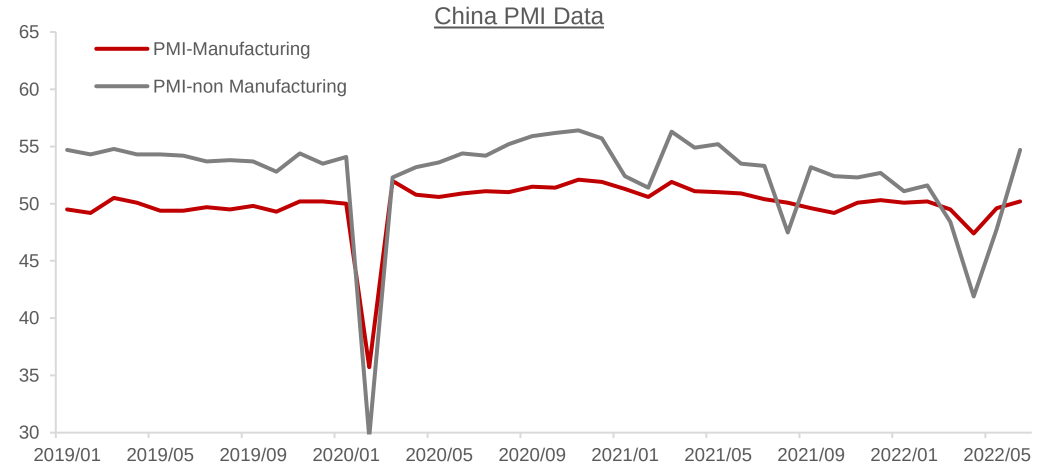
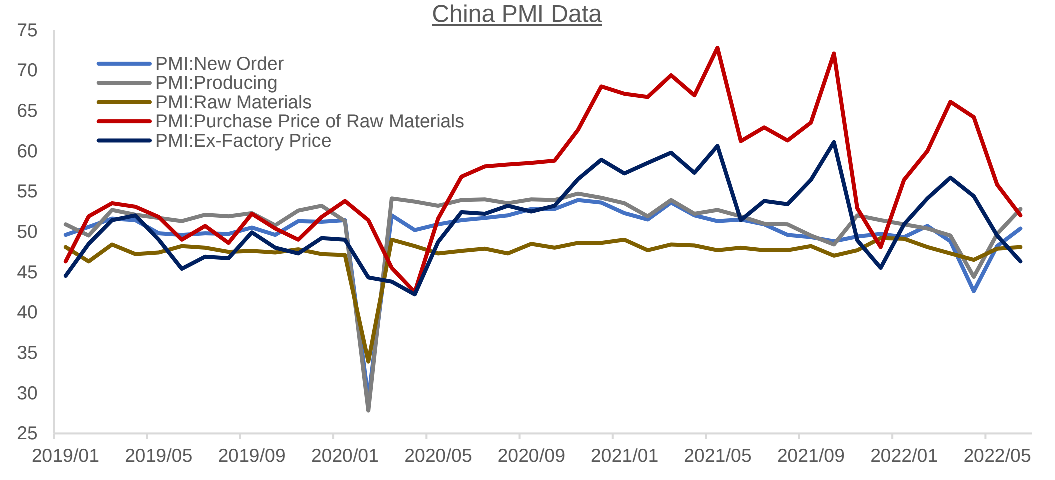
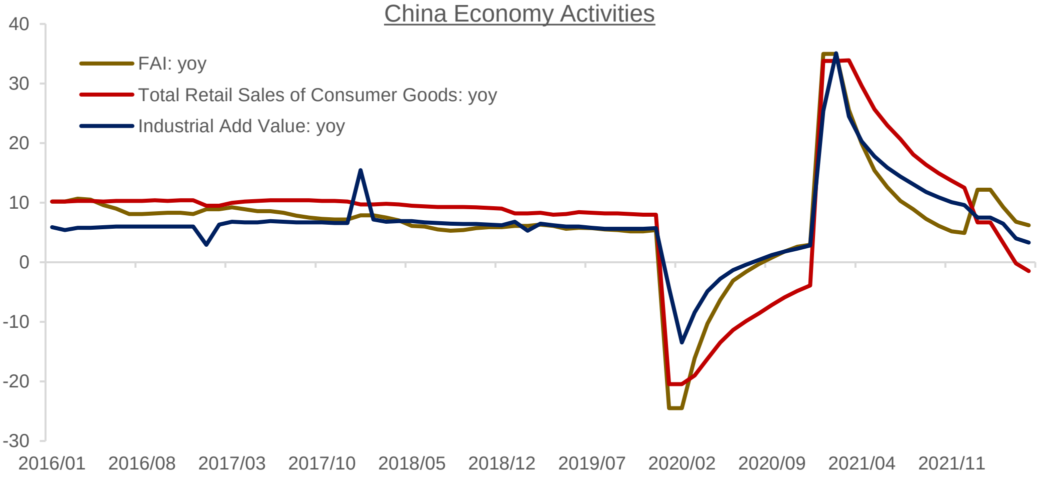
华夏基金(香港) ChinaAMC (HK)







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Stepping into June, red-hot inflation and recession expectations continued to weigh on risk assets, and investors have gradually realized that the impact of this rate hike cycle is different from previous ones. Market focus then shifted to a potential recession in the second half of June, and the U.S. Treasury yield fell back. Global financial markets continue to be dominated by risk-aversion sentiment. The credit market is still under pressure. Overall, high-yield (HY) bonds have underperformed investment-grade (IG) bonds. The United States will either fall into a "stagflation" or "recession" and the economic data in the next three months will be key indicators for market direction and the movement of U.S. Treasury yields. Risk assets will probably be under pressure in the near term. In China, although the pandemic situation has improved and relevant prevention and control measures have been relaxed to a certain extent, economic dynamics remain weak. The improvement of the Chinese economy alone is not enough to reverse the downward pressure in Europe, the United States and most other economies. Despite the fact that the current prices of Chinese-issued USD bonds are not at their lowest levels compared to peers or previous levels, domestic capital has provided IG bonds with strong technical support, which means there are better chances to generate higher short-term returns. For HY bonds, property sales are expected to have bottomed out in May, but the pace of recovery is unstable.

Market Performance

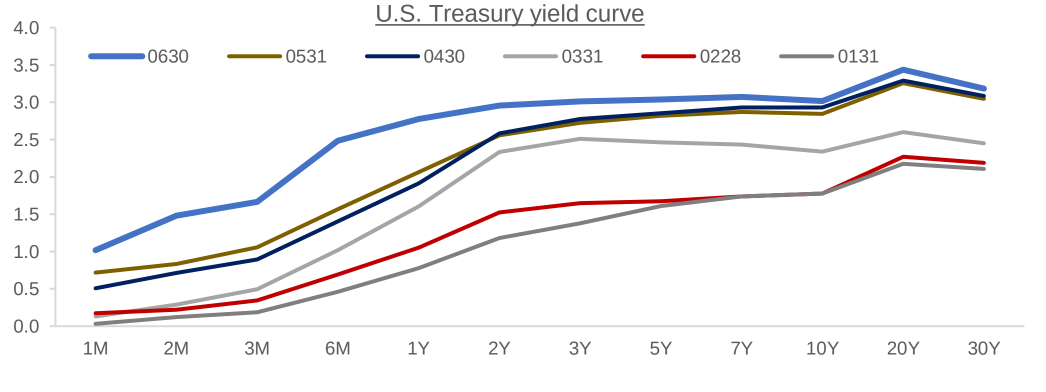
Stepping into June, red-hot inflation and recession expectations continued to weigh on risk assets, and investors have gradually realized that the impact of this rate hike cycle is different from previous ones. The higher-than-expected inflation in May forced the Fed to signal a 75bp rate hike less than a week before the June FOMC meeting. The U.S. Treasury yield curve jumped more than 75bp, and the Fed expectedly announced the largest interest rate hike in 28 years. The market focus then shifted to a potential recession in the second half of June, and the U.S. Treasury yield fell back. Throughout the month, the 10-year U.S. Treasury rose by 17bp with sharp fluctuations and the yield curve flattened. Global financial markets continue to be dominated by risk-aversion sentiment, with European and U.S. equity assets and commodities leading the decline. The dollar index quickly rose and remained volatile at a high level, while the A-share and Hong Kong stock markets led the rise.

United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	2.95	40	222	0.16	3.45
5Y	3.04	22	177	0.60	3.62
7Y	3.07	20	163	0.89	3.60
10Y	3.01	17	150	1.13	3.50
30Y	3.18	14	128	1.66	3.49

China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.44	11	-1	2.18	2.74
5Y	2.63	9	5	2.34	2.89
7Y	2.82	6	2	2.61	3.02
10Y	2.82	2	4	2.68	3.05
30Y	3.29	2	-4	3.22	3.59

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	(0.06)	1	3	-0.15	0.00
5Y	0.03	2	10	-0.14	0.12
7Y	0.16	3	22	-0.14	0.32
10Y	0.23	-1	16	0.00	0.31
30Y	1.24	22	55	0.62	1.31

Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	0.65	15	127	-0.79	1.33
5Y	1.07	23	152	-0.78	1.74
7Y	1.12	19	147	-1.15	1.79
10Y	1.34	21	151	-0.52	1.93
30Y	1.62	24	142	-0.13	1.99



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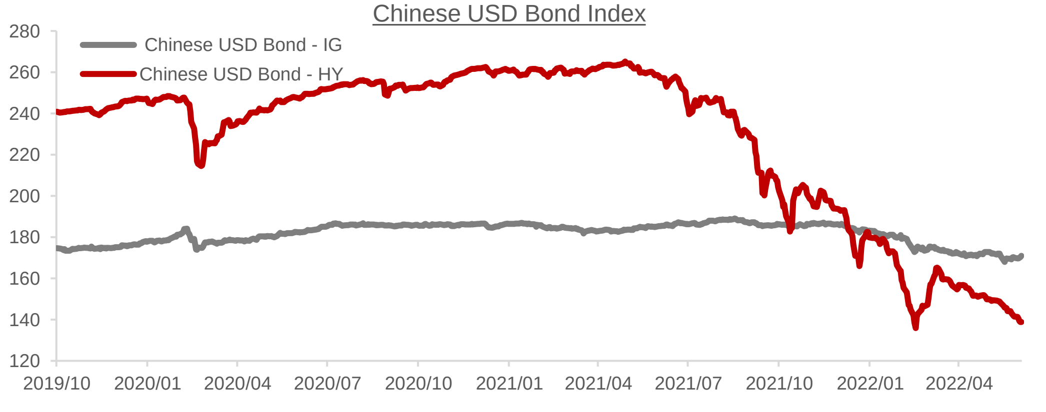
The credit market is still under pressure. Overall, high-yield (HY) bonds have underperformed investment-grade (IG) bonds. Spreads have widened as risk sentiment shifts in global markets, with U.S. IG and HY spreads widening by about 30bp and 150bp in June, respectively. The new issuance of Chinese-issued USD bonds continued to be sluggish. Municipal bonds saw the highest issuance among different types of bonds, while the HY issuance window was shut down. China continues to outperform global peers in IG bonds, with resilience seen across sectors. Spreads narrowed before widening but stayed steady overall. For HY bonds, the panic selloff of Fosun became the focus of the market and reflected the fragility of investor sentiment, though some of the lost ground was quickly recovered afterwards. Though sales data improved month-on-month, investor confidence in the property sector essentially collapsed due to ongoing debt extensions or defaults. Corporate bonds issued by high-quality private companies and weak state-owned companies plummeted. Overall, Chinese IG bonds fell 1.4% in June, and HY bonds fell 11% in the same period, approaching the low point in mid-March.

CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	101	22	52	46	104
HY CDX	579	118	286	272	598
EM CDX	338	67	187	149	352
Bond index					
ICE Asian Dollar Corporate	418	-2.5%	-11.8%	415	495
ICE China Issuers Dollar IG Corporate	200	-1.4%	-8.5%	198	222
ICE China Issuers Dollar HY Corporate	179	-11.0%	-37.9%	169	420
ICE US Corporate	3042	-2.4%	-13.9%	2976	3587
ICE US High Yield	1357	-6.8%	-14.0%	1357	1580
ICE Emerging Markets Corporate	397	-3.4%	-15.6%	395	485
Bloomberg Global-Aggregate	458	-3.2%	-13.9%	450	550
Bloomberg Global-Aggregate 1-3 Year	168	-2.1%	-7.3%	167	185



Economic Data

Inflation still dominates the headline. Impacted by energy and food prices, the U.S. inflation data in May exceeded expectations once again. The leaders of the European Central Bank and the Fed warned that the era of low inflation of the last 20 years is likely ending. Although the job market remains resilient, a number of official agencies have lowered their full-year economic growth forecasts for the U.S. as the consumer confidence index weakens sharply.

In China, with the effective control of the COVID-19, economic activity has recovered significantly. Total social financing has picked up, though structural issues remain. The PMI has climbed above the threshold, and COVID prevention and control measures have also shown signs of slight relaxation.

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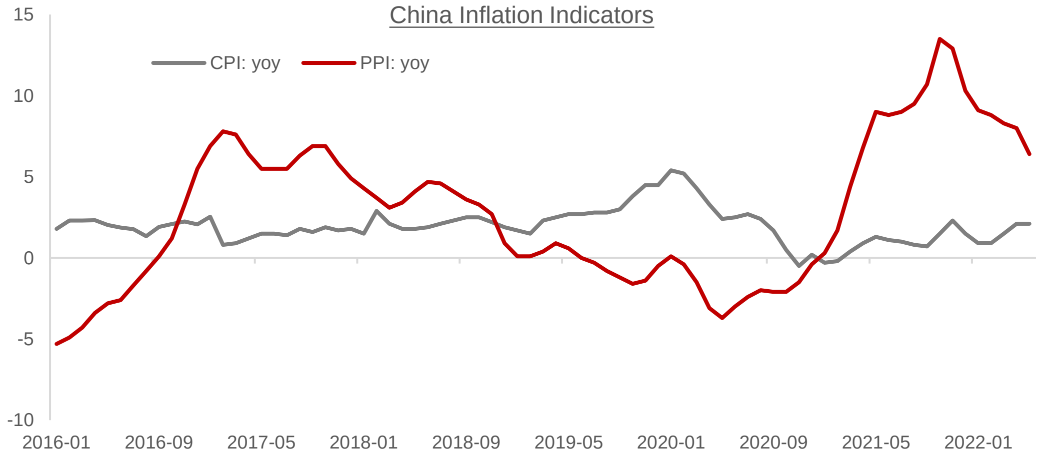
Outlook

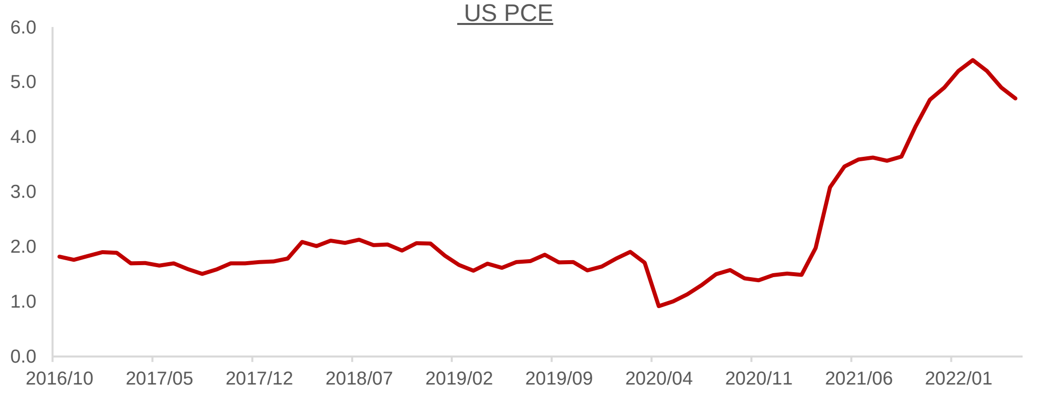
Although Powell has repeatedly expressed that he hopes and has confidence in curbing high inflation through a rapid interest rate hike without triggering a recession, the market believes that the probability of such a situation is close to zero and the United States will either fall into a "stagflation" or "recession". The economic data in the next three months will be key indicators for market direction and the movement of U.S. Treasury yields. But no matter what happens, U.S. Treasury yields will stay highly volatile in the short term. With the tightening of liquidity, SOFR interest rates will surge, and risk assets will probably be under pressure in the near term. In Europe, the current economic and inflation challenges are more severe than those in the United States, and the end of the negative interest rate era after the July hike may bring another shock to the market. In China, although the pandemic situation has improved and relevant prevention and control measures have been relaxed to a certain extent, economic dynamics remain weak. The improvement of the Chinese economy alone is not enough to reverse the downward pressure in Europe, the United States and most other economies.

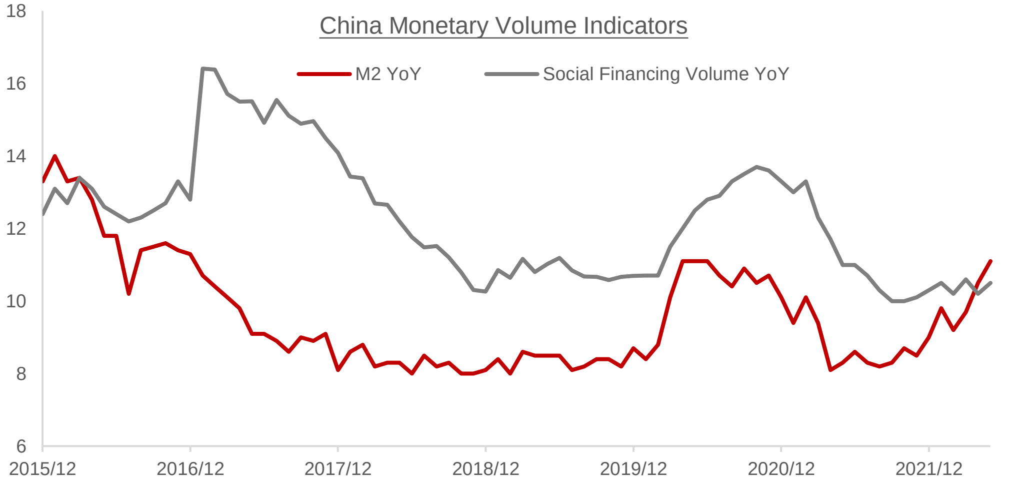
For the credit market, spreads in most sectors widened in June, with HY bonds posting the worst monthly performance since the beginning of the pandemic. As issuance costs increase, new issuance has slowed significantly. We expect credit ratings of companies to gradually deteriorate globally, and there maybe a large-scale downward adjustment. The current spreads in most sectors are around 50-75% of the average level of the past 5 years. We expect the market will continue to slide considering the current macro environment. Chinese-issued USD bonds may present more opportunities. On one hand, domestic monetary policy is relatively loose, and the economy is also showing signs of recovering. On the other hand, Chinese-issued USD bonds are cheaper compared to onshore bonds, and the difference is much higher than that between U.S. equity prices and the A-share prices. Despite the fact that the current prices of Chinese-issued USD bonds are not at their lowest levels compared to peers or previous levels, domestic capital has provided IG bonds with strong technical support, which means there are better chances to generate higher short-term returns. For HY bonds, property sales are expected to have bottomed out in May, but the pace of recovery is unstable. The duration and severity of the crisis have far exceeded that of a "common cold" for the whole industry. It is difficult to foresee repercussions even if the market rebounds. We believe that some private companies will eventually emerge as winners from the turmoil, while at this stage, rebuilding investor confidence in the property sector seems like a distant dream.

In terms of RMB-denominated assets, the domestic monetary condition remains loose, and the yield of sovereign bonds fluctuates in a narrow range. Meanwhile, the market is haunted by an “asset shortage”, and we expect to see many more bearish factors than the bullish factors for the bond market in the future. Benefiting from the improvement in economic expectations and a strong willingness to settle foreign exchange, the yuan has remained strong as the U.S. dollar index increased in June. We expect the probability of further sharp increase of the US dollar index to be low. While the adjustment of COVID prevention and control measures in China may trigger a new wave of outbreaks, our base scenario analysis suggests that China's economy will stabilize and recover, lending support to the RMB exchange rate.

Fixed Income







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