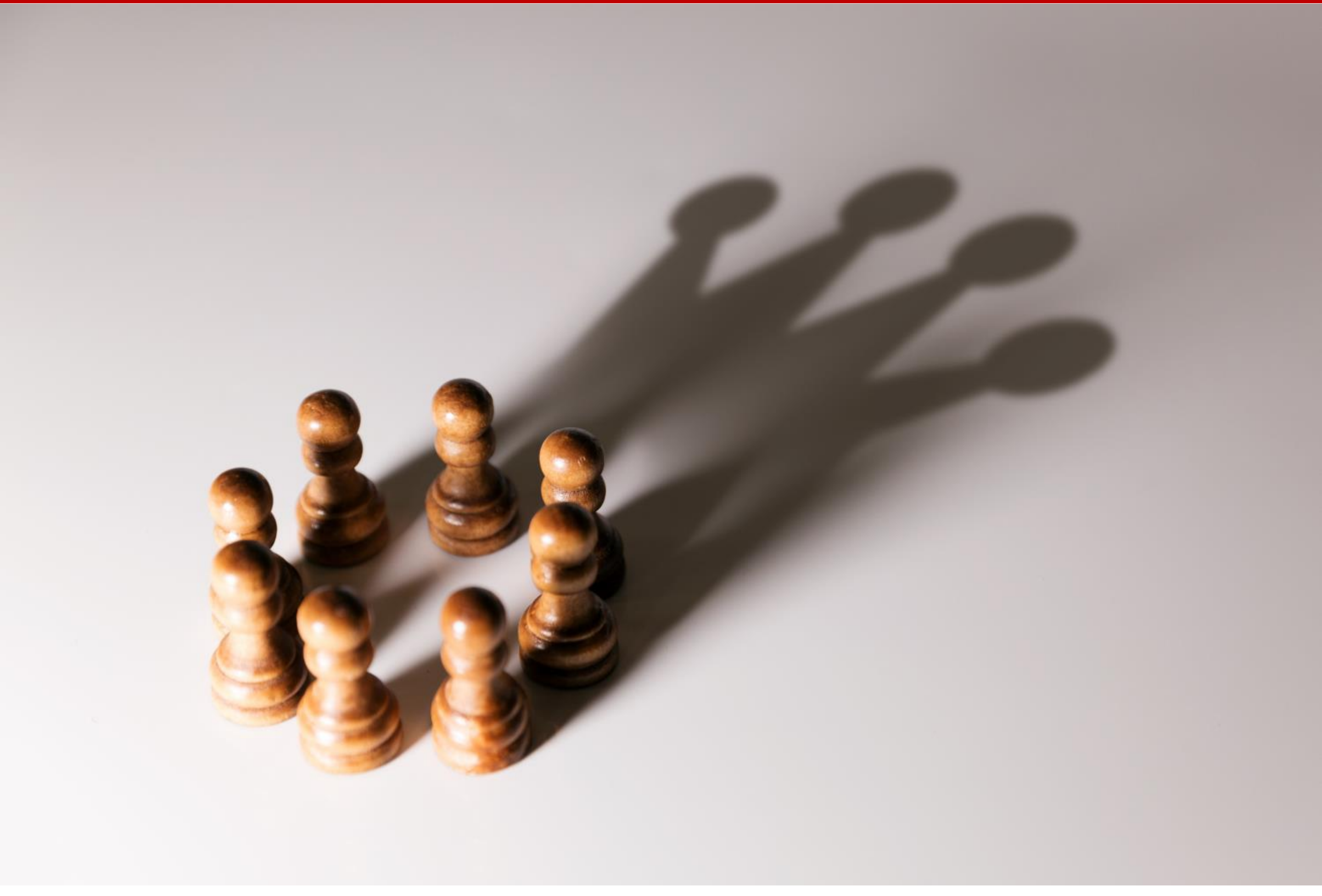

Market Insights

August 2022

MSCI China index declined by 9.97% in the month of July. The outperformance of China equity market reversed, and China equities significantly underperformed other major equity markets in July, driven by both domestic and external factors. The uncertainties regarding China's growth prospects, regulatory friction surrounding the US-listed ADRs, and the mounted US-China relations dampened investors' risk appetite and the performance of China equities. Looking forward, we maintain our long-term positive view on China equity market. The attractive valuation, intact long-term earnings growth and the continuing southbound inflows will support the long-term performance of China equities. In the near term, we expect the market to consolidate due to lack of positive catalysts, and the uncertainties from geopolitical tensions, COVID development and economic recovery.

Market Performance

MSCI China index declined by 9.97% in the month of July. The outperformance of China equity market reversed, and China equities significantly underperformed other major equity markets in July, driven by both domestic and external factors. Domestically, the number of COVID cases in mainland China picked up during the month, which to some degree distorted investors' expectations on China's economic recovery and caused short-term market volatility. The good thing is that we see more swift policy responses and targeted control measures this time and don't expect another large-scale lockdown. Besides, the refusal on homebuyers' mortgage repayments was fomented in July, which added to investors' concerns on China's property market. However, we don't expect it to become a systematic risk, as major banks have announced little impact and manageable risks from mortgage payment suspension, and Chinese government has taken action to handle the problem though it can hardly be completely solved in a short time. Externally, investors are marginally more worried about the US-China relationship. The US is reported to put stricter ban on exports of chip-making tools to China and the Senate passed the narrowest version of the China Competition Bill – the CHIPS Act. Besides, the US audit regulator PCAOB announced that it will not accept any restrictions on auditing Chinese firms listed in NYSE and must have full access to audit any firms it chooses to inspect without any exceptions. The US SEC added more China ADRs including Alibaba to the provisional list on July 29. In addition, China's President Xi and the US President Biden spent over two hours talking through the future of the two countries' relationship, with tension over Taiwan again emerging as a flashpoint. The uncertainties regarding China's growth prospects, regulatory friction surrounding the US-listed ADRs, and the mounted US-China relations dampened investors' risk appetite and the performance of China equities.

The much-awaited July Politburo meeting recognized the lingering downward pressures on the economy and called for policies to be more supportive to help stabilize the economy. The Politburo meeting called for the expansion of final demand with "fuller and better utilization" of policy stimulus that have been announced and emphasized the need to stabilize the property market and ensure home delivery. Also, it reiterated the support for a healthy development of internet "platform" economies and called for the completion of rectification and restructuring of platform enterprises. We think the tone from the meeting is consistent and within expectations, though some investors think information from the meeting somewhat disappointing due to lack of numeric economic growth target and emphasis of strict and rapid COVID control measures.

华夏基金(香港)
ChinaAMC(HK)

Equity

Greater China Indices	Jul Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	4170.10	-7.02	-15.59	3757.09	5143.84
MSCI China	67.00	-9.97	-20.51	58.68	98.59
HSI	20156.51	-7.79	-13.85	18235.48	26822.47
HSCEI	6885.48	-10.19	-16.40	6051.62	9617.55
Global Indices					
S&P 500	4130.29	9.11	-13.34	3636.87	4818.62
Dow Jones Industrial Average	32845.13	6.73	-9.61	29653.29	36952.65
Nasdaq Composite	12390.69	12.35	-20.80	10565.13	16212.23
FTSE 100	7423.43	3.54	0.53	6787.98	7687.27
DAX 30	13484.05	5.48	-15.11	12390.95	16290.19
Nikkei 225	27801.64	5.34	-3.44	24681.74	30795.78

Economic Data

China’s manufacturing PMI fell to 49.0 in July from 50.2 in June, back to the contractionary territory, casting uncertainty on the economy’s path of post-lockdown recovery. The output sub-index fell by 3.0ppt to 49.8 and the new orders sub-index dropped by 1.9ppt to 48.5. The non-manufacturing PMI moderated to 53.8 in July from 54.7 in June, with softened recovery in service sectors due to the COVID outbreaks in multiple provinces but strong expansion in construction sectors. The construction index rose further to 59.2 in July from 56.6 in June, as the construction activity improved on acceleration of construction of infrastructure projects and ongoing fiscal policy support for infrastructure investment.

Future Outlook

Looking forward, we maintain our long-term positive view on China equity market. The attractive valuation, intact long-term earnings growth and the continuing southbound inflows will support the long-term performance of China equities.

In the near term, we expect the market to consolidate due to lack of positive catalysts, and the uncertainties from geopolitical tensions, COVID development and economic recovery.

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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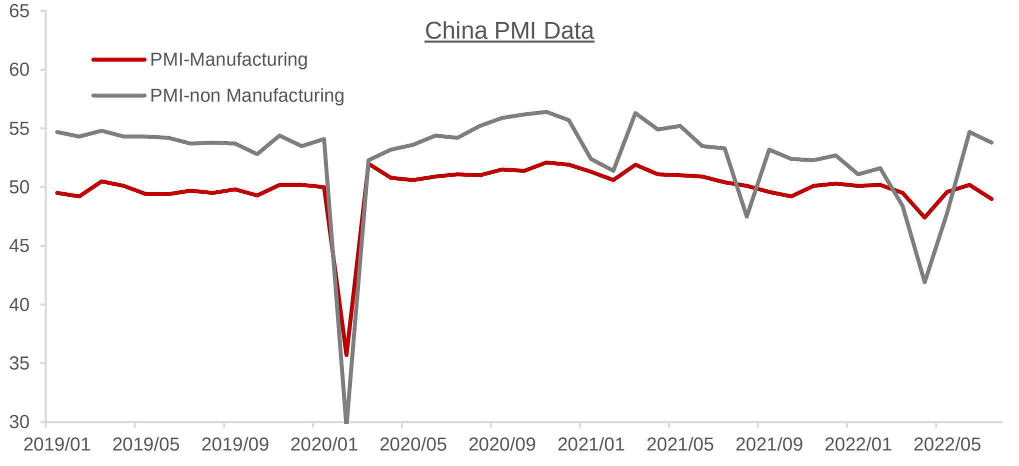
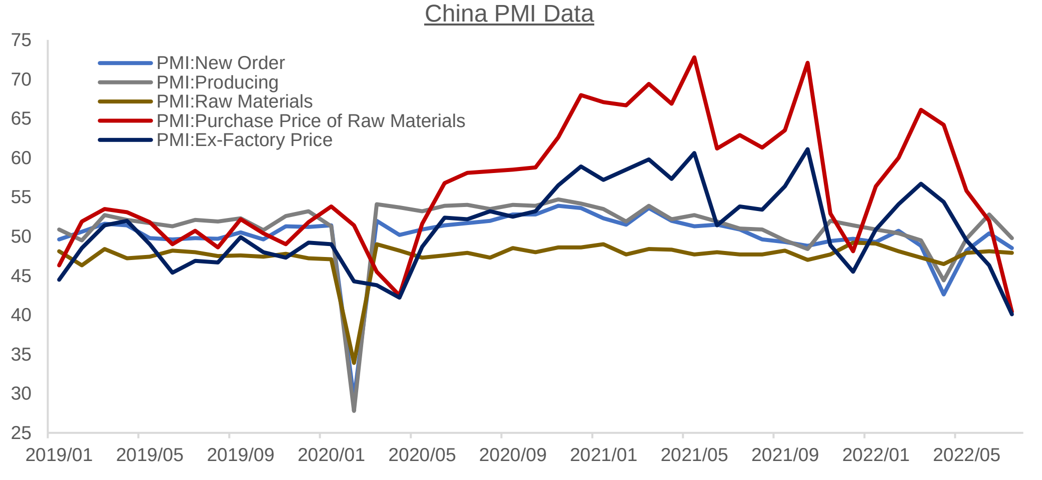
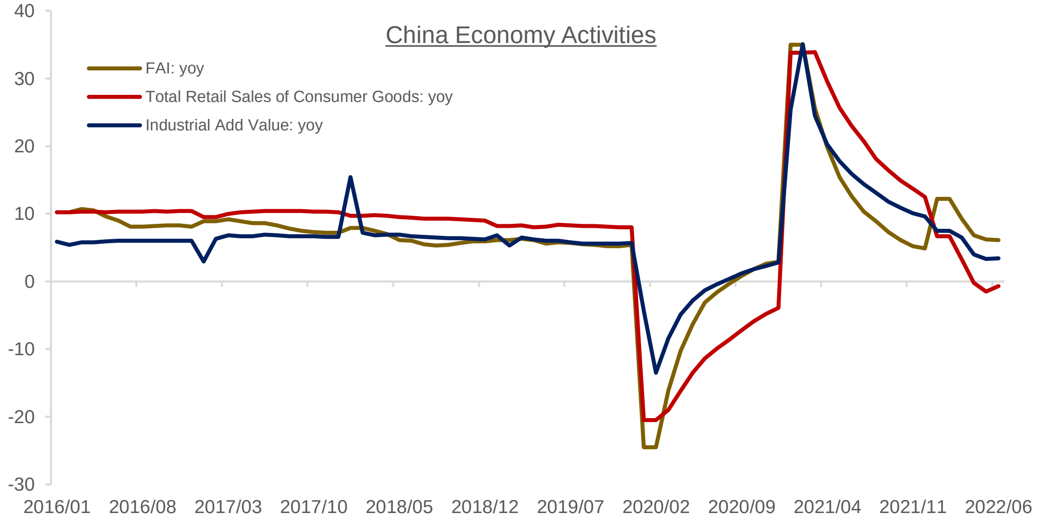
Equity







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Fixed Income

In July, as the U.S. economy met the bar for a 'technical recession' and the rate hikes in Europe and the U.S. were being conducted as planned, markets repriced the Fed's path for rate hikes. After risk sentiment ran its course, markets started to price the policy turnaround next year in advance. Risk assets rebounded to some extended in both Europe and the U.S., while the dollar index peaked and fell. In China, asset prices were weak as investors remained concerned by risk events such as mortgage boycotts and tensions in China-U.S. relations. In the Chinese USD bond market, the primary market was rather quiet, with new issues concentrating in the LGFV sector. Although non-farm employment data remained robust, there was a visible pickup in the weekly initial jobless claims. In China, economic data started to show weakness after a brief rebound in the previous period. Despite the large drop in yields recently, at the moment we are still far from getting to the end of the hiking cycle. Meanwhile, it is difficult to arrive at any conclusions for when inflation will reach its peak and fall. Therefore, in the short term, volatility in the yields is still expected. In July Chinese assets underperformed and did not experience any rebounds as seen in other markets. In the onshore market, liquidity was abundant. The politburo meeting did not give out additional signals for economic stimulus. We expect the government to further fade out the economic growth target.

Market Performance

In July, as the U.S. economy met the bar for a 'technical recession' and the rate hikes in Europe and the U.S. were being conducted as planned, markets repriced the Fed's path for rate hikes. The IMF further dimmed its global economic outlook. The FOMC meeting gave mixed signals but the markets interpreted the meeting as relatively dovish. U.S. Treasury yields fell notably, especially in the belly of the curve. The 2-year and 10-year yield inversion exceeded 20bps, indicating a strong expectation for recession. After risk sentiment ran its course, markets started to price the policy turnaround next year in advance. Risk assets rebounded to some extended in both Europe and the U.S., while the dollar index peaked and fell. In China, asset prices were weak as investors remained concerned by risk events such as mortgage boycotts and tensions in China-U.S. relations.

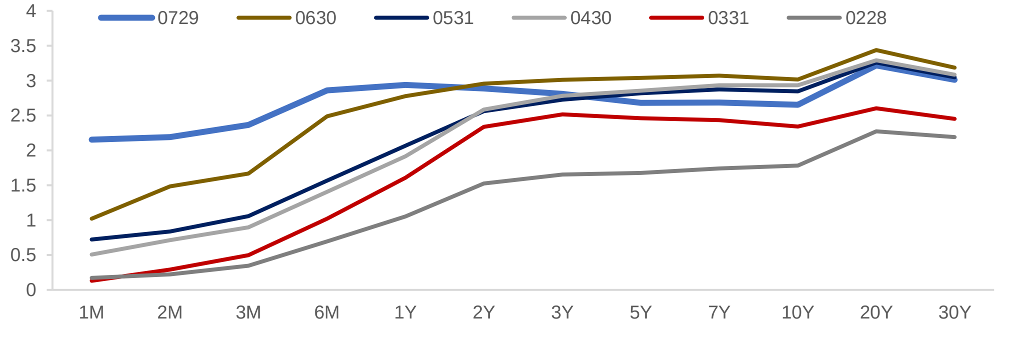
United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	2.88	-7	215	0.16	3.45
5Y	2.68	-36	141	0.60	3.62
7Y	2.68	-39	124	0.89	3.60
10Y	2.65	-36	114	1.13	3.50
30Y	3.01	-17	111	1.66	3.49

China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.30	-14	-15	2.18	2.74
5Y	2.51	-12	-7	2.34	2.89
7Y	2.74	-8	-6	2.61	3.02
10Y	2.77	-5	-1	2.68	3.05
30Y	3.25	-4	-8	3.21	3.59

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	(0.08)	-2	1	-0.15	0.00
5Y	(0.02)	-5	5	-0.14	0.12
7Y	0.05	-11	11	-0.13	0.32
10Y	0.19	-5	11	0.00	0.31
30Y	1.20	-4	51	0.62	1.32

Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	0.28	-37	90	-0.79	1.33
5Y	0.53	-54	98	-0.78	1.74
7Y	0.59	-53	94	-1.15	1.79
10Y	0.82	-52	99	-0.52	1.93
30Y	1.07	-54	88	-0.13	1.99

U.S. Treasury yield curve



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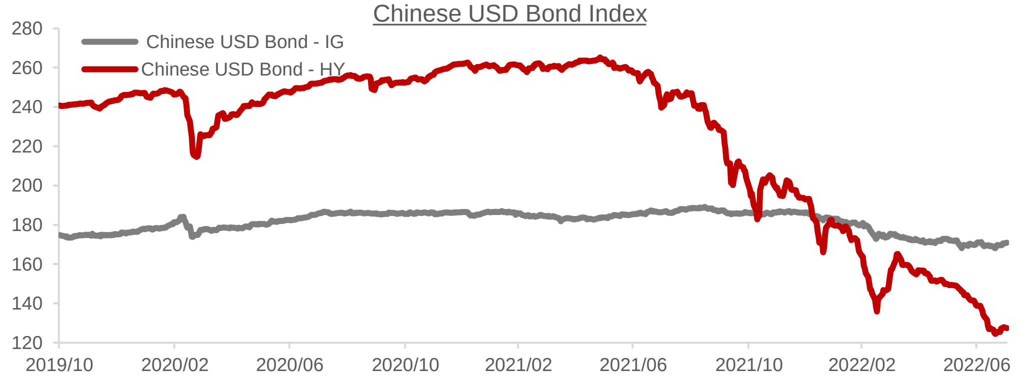
The corporate bond market rebounded to some degree. Following global market risk sentiment, in Europe and the U.S., July produced the best year-to-date monthly return: credit spreads tightened, new issue activities picked up, and losses in June were partially recovered. In the Chinese USD bond market, the primary market was rather quiet, with new issues concentrating in the LGFV sector. China's investment grade bonds underperformed, with mortgage boycotts leading some banks' subordinated bonds and some regions' weak LGFV bonds to drop in value. The AMC sector also fell by large margins at the beginning of the month, although high quality names remained steady. In China's high yield space, the increasingly common occurrence of mortgage boycotts pushed the real estate crisis to a new stage. As private developers' sales figures remained grim, investors were not yet convinced by frequent rumors of policy support to the sector. Overall, in July China's investment grade bonds were down by 0.3%. China's high yield bonds fell by 10.7%, marking a halfway drop from the peak last year.

CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	80	(21)	31	46	104
HY CDX	471	(108)	178	272	598
EM CDX	327	(12)	175	149	395
Bond index					
ICE Asian Dollar Corporate	419	0.2%	-11.7%	409	494
ICE China Issuers Dollar IG Corporate	199	-0.3%	-8.8%	196	222
ICE China Issuers Dollar HY Corporate	160	-10.7%	-44.5%	155	397
ICE US Corporate	3131	2.9%	-11.4%	2976	3587
ICE US High Yield	1439	6.0%	-8.9%	1357	1580
ICE Emerging Markets Corporate	402	1.1%	-14.7%	391	485
Bloomberg Global-Aggregate	468	2.1%	-12.1%	450	550
Bloomberg Global-Aggregate 1-3 Year	168	0.2%	-7.2%	165	185



Economic Data

Although U.S. inflation once again exceeded expectations, the markets reacted more mildly compared to June. U.S. second quarter GDP continued to shrink on a year-over-year basis, with structural deterioration in the economy further exacerbating the woes. Although non-farm employment data remained robust, there was a visible pickup in the weekly initial jobless claims. Therefore, the Fed still faces a challenging task at hand. In Europe, the ECB hiked the rate by 50bps, slightly overshooting market expectations. However, the Euro zone is still under tremendous pressure caused by political tensions, inflation, and other factors such as financial fragmentation and issues with natural gas supply.

In China, economic data started to show weakness after a brief rebound in the previous period.

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Outlook

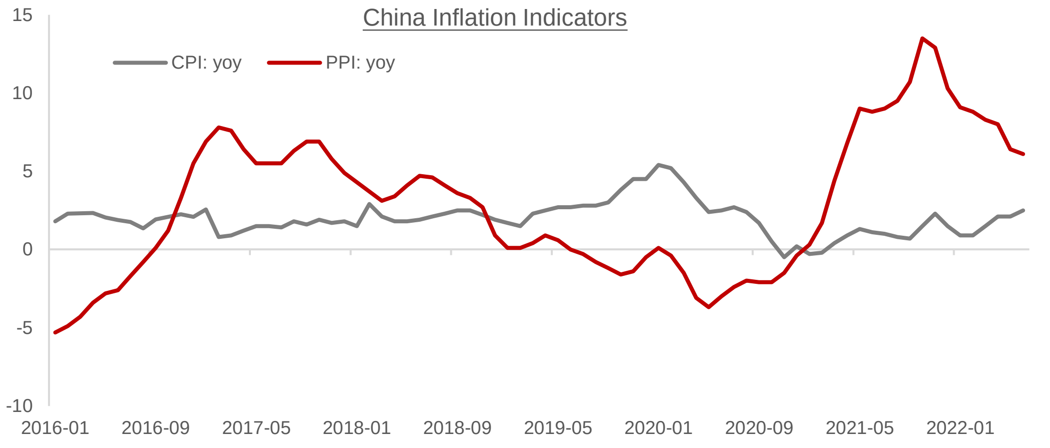
Under inflationary pressure, the first stage of rapid rate hikes is potentially at its end: as the markets expect, the future pace for rate hikes will likely slow down. The inflation and employment statistics in July and August may form the basis for the Fed's judgement on the economic conditions, and in turn determine policy and market directions. Despite the large drop in yields recently, at the moment we are still far from getting to the end of the hiking cycle. Meanwhile, it is difficult to arrive at any conclusions for when inflation will reach its peak and fall. Therefore, in the short term, volatility in the yields is still expected. In terms of China-U.S. relations, as the two nations both face economic pressure and elections this year, chances of a rapid deterioration or improvement in the bilateral relations remain low; nonetheless, it is still a possibility for bilateral tensions to trigger a new black swan event in the geopolitical space after the Russia-Ukraine conflict. For Europe, the issues at hand are more severe than in the U.S., and the European hiking cycle is still at the beginning stage. Therefore, the euro and other European assets still face mounting pressure.

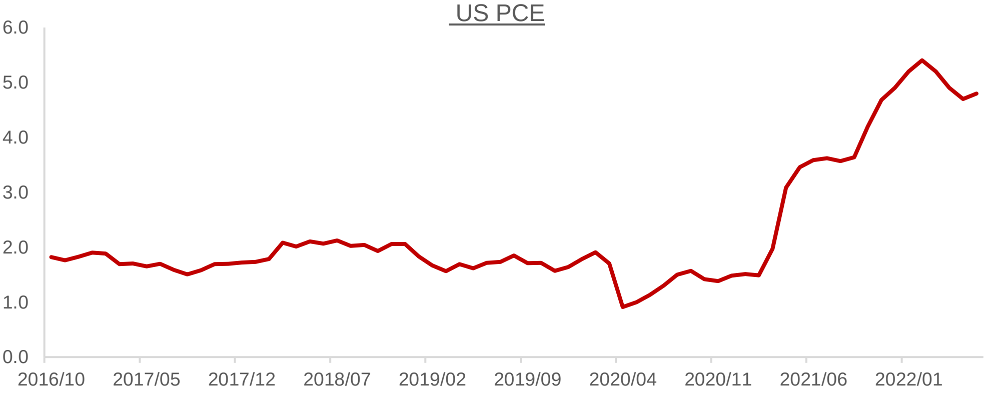
For corporate bonds, most sectors saw credit spreads tighten during the month as well as the slowing of capital outflows in the emerging markets, although the tightening in July was dwarfed by the widening in June, both in terms of speed and extent. The rebound in July is likely the result of a correction to the previous over-selling, as well as expectations of monetary policy turnaround for next year. Therefore, the upward momentum might still persist in the short term, but it is not likely for risk sentiment to change fundamentally. Under pressures caused by company fundamentals and valuations, markets are expected to continue experiencing volatility, even with possibility of potential declines.

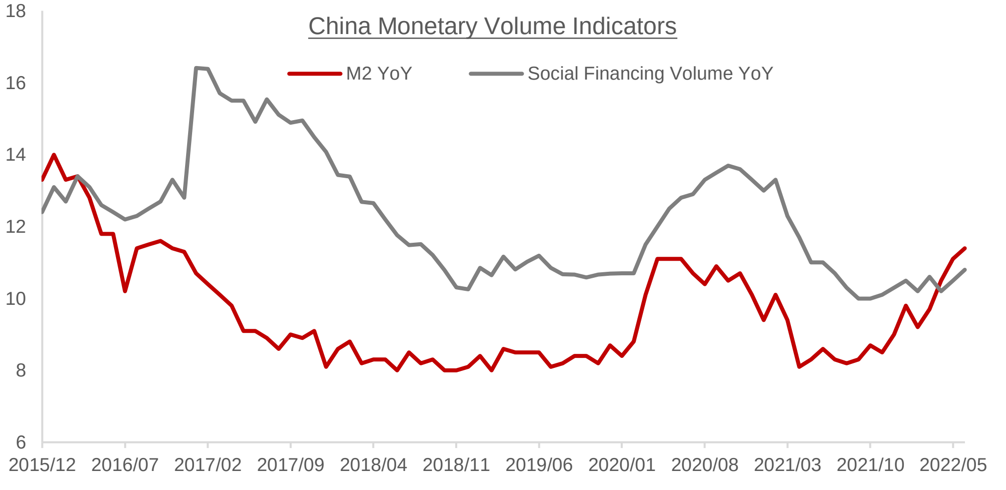
After three months of relatively good performance, in July Chinese assets underperformed compared to other countries, and did not experience any rebounds as seen in other markets. Salient factors include the mortgage boycotts, China-U.S. relations, and lacklustre performance for some companies. Moreover, after outperformance for three consecutive months, Chinese USD bonds' valuation advantage shrank, compared to both the onshore market and other countries. Nonetheless, there remains strong support from the technical side, while investors still need to heed possible risk aversion and capital outflows resulting from escalating tensions in China-U.S. relations. In the high yield space, the government likely sees the mortgage boycotts as having much more severe social implications than the default of property developers. Currently the government still emphasizes on ensuring housing completion instead of salvaging developers. Against such backdrop, investors are much more reactive to bad news than good news, and it remains a possibility for private developers in default to try getting nationalized again. Meanwhile, there are still property developers which, acting in good faith, attempt to pay their offshore debts. When future policy support ultimately materializes and leads the property sector back to the right track, investors should hope to see high-quality private real estate developers to eventually survive, instead of a non-discriminating annihilation for all private real estate companies.

In the onshore market, liquidity was abundant. The politburo meeting did not give out additional signals for economic stimulus. As the economic and credit data in July puts pressure on policymakers, we expect the government to further fade out the economic growth target. As supply-side risks subside for onshore bonds, the falling of yields becomes the path of lesser resistance. For the RMB, although China still faces risks from economic downturn and China-U.S. relations, current conditions are different from historical precedents: right now, China does not have signs of large-scale capital outflows, while the significant trading surplus and foreign reserve offer strong buffer for the yuan. As the dollar index is at a pivotal level of support and could potentially shift away from the upward trend, we expect the RMB to be supported, and the possibility for the yuan to substantially depreciate remains low.

Fixed Income







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