Market Insights

September 2022

MSCI China index slightly rose by 0.12% in the month of August, and outperformed most overseas equity markets, mainly driven by China's resumed stabilization measures and the better-than-expected earnings growth of most Chinese Internet giants. The process of China's economic recovery slowed down in July, and both the monthly credit data and monthly macro-economic data came in lower than expected, which highlighted the soft domestic demand, the weak private sector sentiment, and the negative impacts from recent COVID resurgence in mainland China. The good thing is that China resumed the pro-growth policies after the signs of economic slowdown emerged in July. The PCAOB and the CSRC signed a preliminary agreement which allows PCAOB's access to the audit papers of Chinese ADRs. Though PCAOB said it was just the first step in removing the delisting risk of Chinese ADRs, we expect to see the final agreement reached by the end of this year. 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 offshore China equities. In the near term, we expect the market to consolidate with relatively high volatility, due to lack of positive catalysts and continuing uncertainties from geopolitical tensions, COVID development and economic recovery.

Market Performance

MSCI China index slightly rose by 0.12% in the month of August, and outperformed most overseas equity markets, mainly driven by China's resumed stabilization measures and the better-than-expected earnings growth of most Chinese Internet giants. The process of China's economic recovery slowed down in July, and both the monthly credit data and monthly macro-economic data came in lower than expected, which highlighted the soft domestic demand, the weak private sector sentiment, and the negative impacts from recent COVID resurgence in mainland China. The good thing is that China resumed the pro-growth policies after the signs of economic slowdown emerged in July, which helped the momentum and sentiment pick-up and led to China equities' relative resilience in August. Following the 10bps MLF cut on Aug 15, the PBoC cut the 1yr and 5yr LPR by 5bps and 15bps respectively to support the real economy and stabilize China's property market. The State Council's meeting on Aug 24 announced a new round of stimulus package measures with a headline figure of 1 trillion yuan (0.8% of GDP), including 500 billion yuan additional special local government bonds, 300 billion yuan policy bank financing to support investment projects, and 200 billion yuan special bonds to ensure stable energy supply.

Besides, the PCAOB and the CSRC signed a preliminary agreement which allows PCAOB's access to the audit papers of Chinese ADRs. Though PCAOB said it was just the first step in removing the delisting risk of Chinese ADRs, we expect to see the final agreement reached by the end of this year. However, the US-China relations continued to disrupt China's equity market, as the US government imposed more restrictions on semiconductor-related exports to China, following the passage of the CHIPS and Science Act.

Greater China Indices	Aug Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	4078.84	-2.19	-17.44	3757.09	5143.84
MSCI China	67.08	0.12	-20.42	58.68	98.59
HSI	19954.39	-1.00	-14.72	18235.48	26560.04
HSCEI	6865.12	-0.30	-16.65	6051.62	9551.38
Global Indices					
S&P 500	3955.00	-4.24	-17.02	3636.87	4818.62
Dow Jones Industrial Average	31510.43	-4.06	-13.29	29653.29	36952.65
Nasdaq Composite	11816.20	-4.64	-24.47	10565.13	16212.23
FTSE 100	7284.15	-1.88	-1.36	6787.98	7687.27
DAX 30	12834.96	-4.81	-19.20	12390.95	16290.19
Nikkei 225	28091.53	1.04	-2.43	24681.74	30795.78

Economic Data

China’s manufacturing PMI edged up to 49.4 in August from 49.0 in July, but remained in contractionary territory. The sequential improvement was influenced by the regional Omicron resurgence, the extreme heat and the power rationing. The output sub-index remained unchanged at 49.8 and the new order sub-index rose to 49.2 in August from 48.5 in July, reflecting the still weak production and demand. The non-manufacturing PMI further moderated to 52.6 in August from 53.8 in July, with softened recovery in both construction and service sectors.

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 offshore China equities. In the near term, we expect the market to consolidate with relatively high volatility, due to lack of positive catalysts and continuing uncertainties from geopolitical tensions, COVID development and economic recovery.

We expect the upcoming August credit and macro-economic data to show marginal improvement thanks to a low base, while the recent regional COVID outbreaks, the drought shock and the regional power shortage may weigh on activities. Externally, the hawkish speech delivered by Fed Chair Jerome Powell at the Jackson Hole Symposium knocked global markets into risk-off mode. The USD index broke out to 20yr highs and the real bond yields in the US and EU also moved up significantly, which may put pressure on the performance of global risk assets.

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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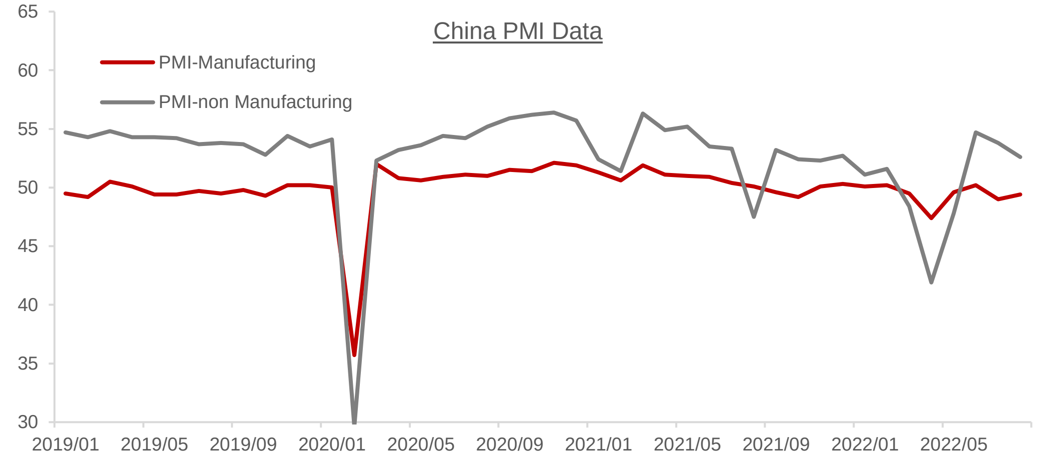
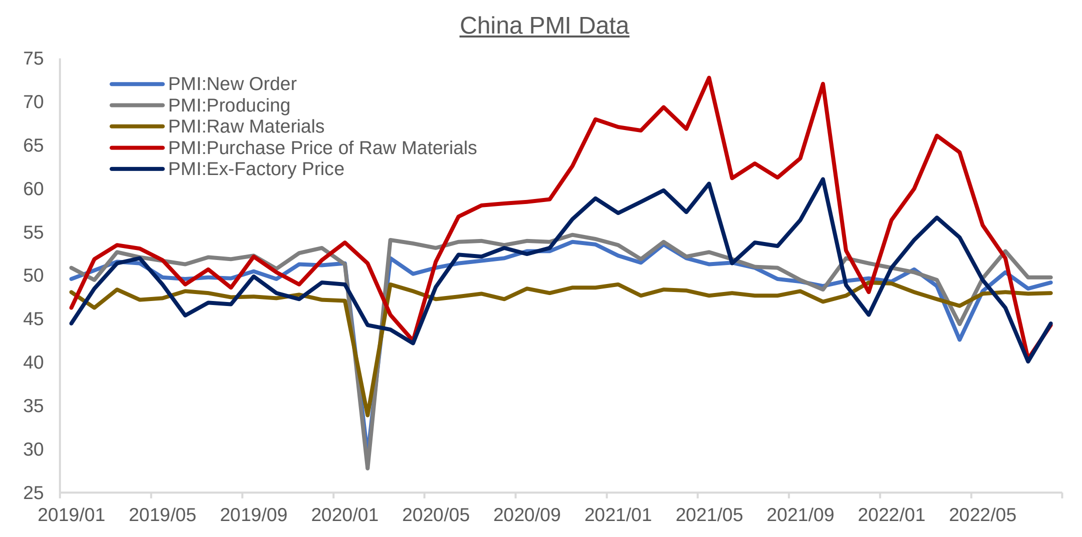
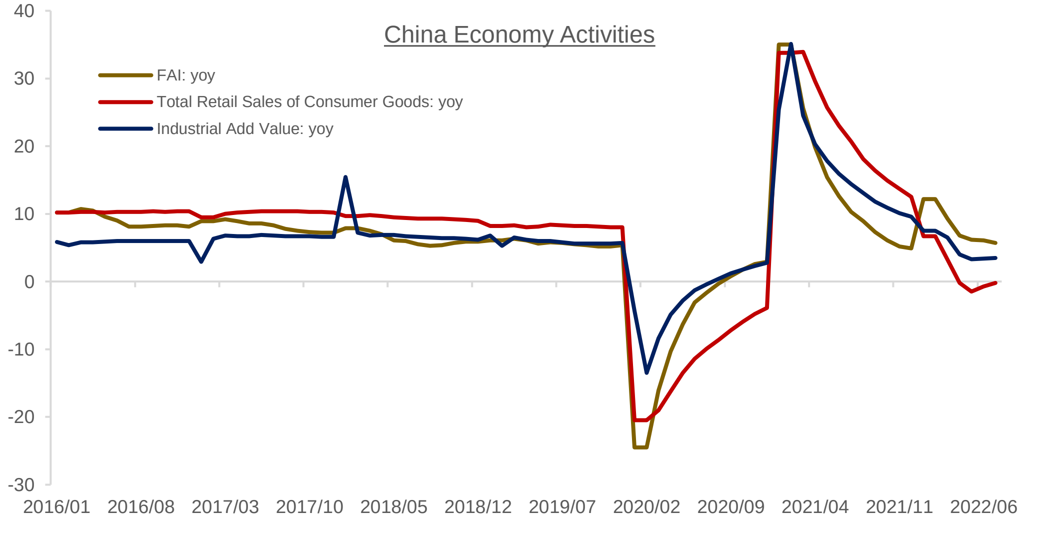
Equity







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Fixed Income

Markets were volatile in August, the first half of which saw that rebound trades in July continued, based on expectation of a possible recession and a potential future rate cut down the line. Chair Powell's hawkish address at Jackson Hole became the epitome of the central bank's determination to fight inflation. Risk sentiment quickly turned south. Most risk assets declined in value over the month, while the dollar index broke above 20-year highs. The overall performance of Chinese USD bonds leading other bond markets, especially in the second half of the month. For investment grade bonds, risk sentiment returned as tensions along the Taiwan Strait cooled down a bit and policy support was introduced as the economy hit the bottom. China and U.S. reached a partial audit agreement, supporting the performance of the TMT sector. The looming recession may just be a matter of time or criteria, the market's expectation and reaction will be a determining factor. For U.S. rates, a hawkish Fed continues to put upward pressure on the front end of the curve, while the longer tenors are expected to oscillate amid expectations of inflation and recession. In the high yield property sector, although the government has given clear signals to stabilize the property sector, there remains high uncertainties on when the sales could recover and how well the policies could help with the quality developers' liquidity conditions. Despite our belief that quality companies will eventually triumph, one must remain cautious on the volatilities of asset prices along the way.

Market Performance

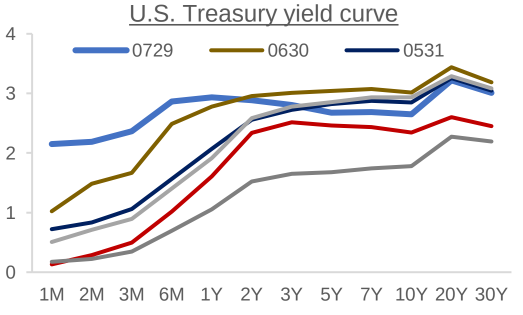
Markets were volatile in August, the first half of which saw that rebound trades in July continued, based on expectation of a possible recession and a potential future rate cut down the line. Nonetheless, starting from mid-August, some U.S. economic data remained resilient and Fed officials pressed on with the hawkish talk, leading markets to think that inflation might last longer than expected. At the end of the month, Chair Powell's hawkish address at Jackson Hole became the epitome of the central bank's determination to fight inflation. Risk sentiment quickly turned south. U.S. Treasury yields climbed during the month, with 2-year and 10-year yields both rising by over 50bps. The 2-to-10-year differential was still deeply inverted, while government bond yields in Europe also climbed substantially. Most risk assets declined in value over the month, while the dollar index broke above 20-year highs. Chinese USD bonds again displayed a different trend, with the overall performance leading other bond markets, especially in the second half of the month.

United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	3.49	61	276	0.19	3.55
5Y	3.35	67	209	0.74	3.62
7Y	3.31	63	187	1.04	3.60
10Y	3.19	54	168	1.26	3.50
30Y	3.29	28	139	1.66	3.49

China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.18	-12	-27	2.18	2.74
5Y	2.40	-11	-18	2.34	2.89
7Y	2.62	-12	-18	2.58	3.02
10Y	2.64	-12	-14	2.61	3.05
30Y	3.11	-14	-22	3.08	3.59

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	(0.08)	-1	1	-0.14	0.00
5Y	0.01	4	9	-0.12	0.12
7Y	0.14	9	20	-0.11	0.32
10Y	0.23	4	16	0.02	0.31
30Y	1.20	-1	51	0.64	1.32

Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	1.20	92	182	-0.79	1.33
5Y	1.39	86	184	-0.68	1.74
7Y	1.37	78	173	-1.15	1.79
10Y	1.54	72	172	-0.41	1.93
30Y	1.63	56	143	-0.13	1.99



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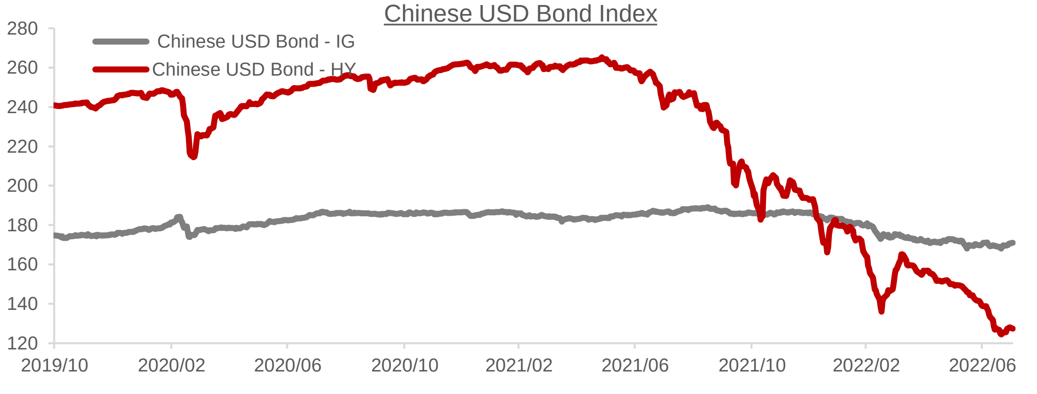
The corporate bond market went through a "down-up" pattern, with emerging markets outperforming the U.S., which in turn outperformed Europe. In the first half of the month, overall credit spreads narrowed following general market sentiment. In the second half, however, as the Fed sent out hawkish signals, spreads started to widen. Meanwhile, Chinese USD bonds were down at first but ended the month higher. For investment grade bonds, risk sentiment returned as tensions along the Taiwan Strait cooled down a bit and policy support was introduced as the economy hit the bottom. China and U.S. reached a partial audit agreement, supporting the performance of the TMT sector. Spreads in the SOEs and financial sector were also close to this year's lows. In the high yield space, as quality private real estate developer was eventually able to issue new bonds in the onshore market and the government offered policy support, the market rebounded with a fervor. As a whole, in August Chinese investment grade bonds were down by 0.6% while high yield bonds were up by 9.4%.

CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	92	12	43	46	104
HY CDX	533	62	240	272	598
EM CDX	327	0	175	150	395
Bond index					
ICE Asian Dollar Corporate	417	-0.3%	-11.9%	409	493
ICE China Issuers Dollar IG Corporate	198	-0.6%	-9.3%	196	222
ICE China Issuers Dollar HY Corporate	175	9.4%	-39.3%	149	382
ICE US Corporate	3048	-2.7%	-13.7%	2976	3587
ICE US High Yield	1404	-2.4%	-11.0%	1357	1580
ICE Emerging Markets Corporate	400	-0.4%	-15.1%	391	485
Bloomberg Global-Aggregate	450	-3.9%	-15.6%	445	547
Bloomberg Global-Aggregate 1-3 Year	165	-2.0%	-9.1%	164	185



Economic Data

As energy prices fell back, U.S. inflation eventually cool down by a slight margin, although inflation persisted at high levels in the service sector. Employment-related indicators were strong, but imbalances of supply and demand in the labor market still lingered. Consumption was strong, but PMI was weak, meeting the criteria for the "stagflation" scenario. The futures market showed an increasing possibility of a 75bp rate-hike in Fed's September meeting. In Europe, the natural gas crisis before the looming winter complicated inflation and other economic issues. The IMF further downgraded its world economic outlook.

In China, the social financing data was far below expectations, as other economic data also appeared sluggish. The PBoC cut its policy rates to counter economic downside risks, contrary to market expectation.

Outlook

Powell's Jackson Hole speech reaffirmed that the Fed's primary goal in the near-to-medium term is to control inflation, even facing the potential cost of a recession. Core CPI, especially CPI in the service sector, will be essential in the Fed's future path of rate hikes. Given data on key areas such as employment, consumption, and housing, inflation is expected to remain at elevated levels. The looming recession may just be a matter of time or criteria: it could happen earlier or later than expected, and also depends on the official designation for a recession. Therefore, the market's expectation and reaction will be a determining factor. For U.S. rates, a hawkish Fed continues to put upward pressure on the front end of the curve, while the longer tenors are expected to oscillate amid expectations of inflation and recession. The shape of the yield curve is still to be notably inverted in the foreseeable future. In Europe, policy makers face a myriad of problems, among the most significant of which is the energy crisis in the upcoming winter. Inflation will be further pushed upward because of this. Therefore, we see the ECB move towards a rate-hike path which could be more drastic than expected. The rise in rates and rate differentials across countries would also make countries with less fiscal capacity to face higher debt pressure.

For corporate bonds, most sectors' valuations at the end of August are close to the early-June levels, with room for downsides compared to the lows in early July. Given the central banks' hawkish stance, market risk sentiment, and fund flows, it might be hard to further sustain the rebound in the second half of the year. If future inflation levels persist at high levels, then spreads could keep widening; otherwise, it is likely for spreads to move inside bounded ranges. When looking at yields and fundamentals, the inversion of U.S. rates makes short term bonds more attractive, safer bets.

As for Chinese USD bonds, the performance was relatively independent as it has been this year. In the investment grade space, as onshore interest rates decline, even though hedging costs rise, the notable spread between onshore and offshore will push onshore funds to maintain strong support for high quality issuers in the SOE and financial sector. That being said, currently high valuations make it difficult for spreads to continue tightening, while the TMT and AMC sectors which underperformed early this year might be able to offer some value if they were to catch up. In the high yield property sector, the rebound for high quality developers seems to be more like a correction of the over-selling in previous sessions. The financial reports of the first half of the year demonstrate the difficulties of the sector. Although the government has given clear signals to stabilize the property sector, there remains high uncertainties on when the sales could recover and how well the policies could help with the quality developers' liquidity conditions. Despite our belief that quality companies will eventually triumph, one must remain cautious on the volatilities of asset prices along the way.

There is also pressure on the Chinese economy. The ripple effects of the real estate sector's downturn, timing of the zero Covid policy, and the strength of exports are among the deciding factors for the economy in the second half of the year. For RMB assets, the yuan's liquidity remained balanced in September, although it is difficult for money market rates to return to pre-rate-cut levels without open market injections from the central bank, leaving limited room for short-term interest rates to decline. While the economy has prospects to show marginal improvement, the strength of the recovery remains limited. The medium- and long-term yields are expected to oscillate at low levels. The RMB exchange rate continues to depend on the dollar index and the domestic economy. Recent exchange rate trends imply that policy makers may intend to manage market expectations. Therefore, against a basket of currencies, the yuan may not continue weakening in a prolonged period of time.

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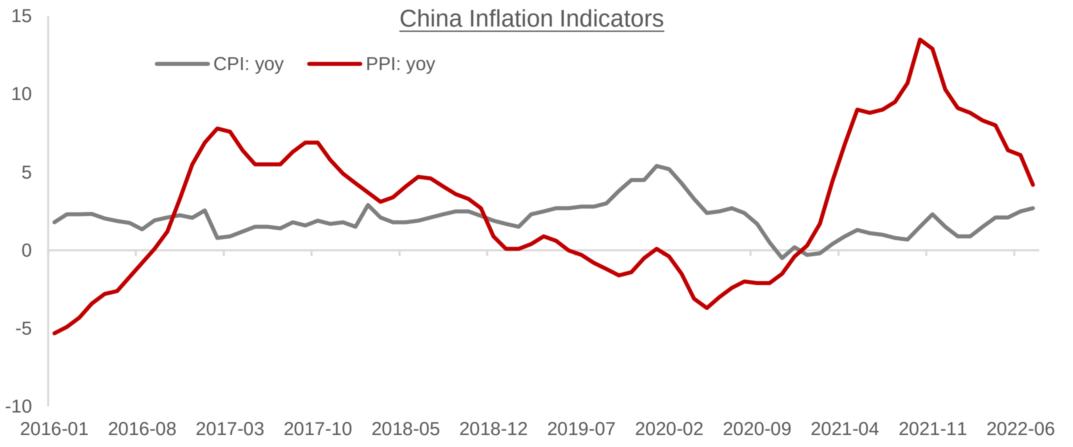

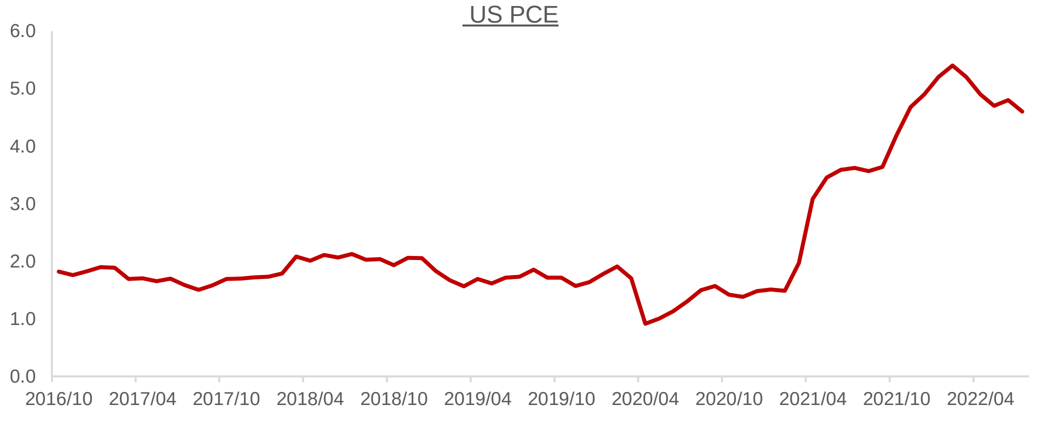

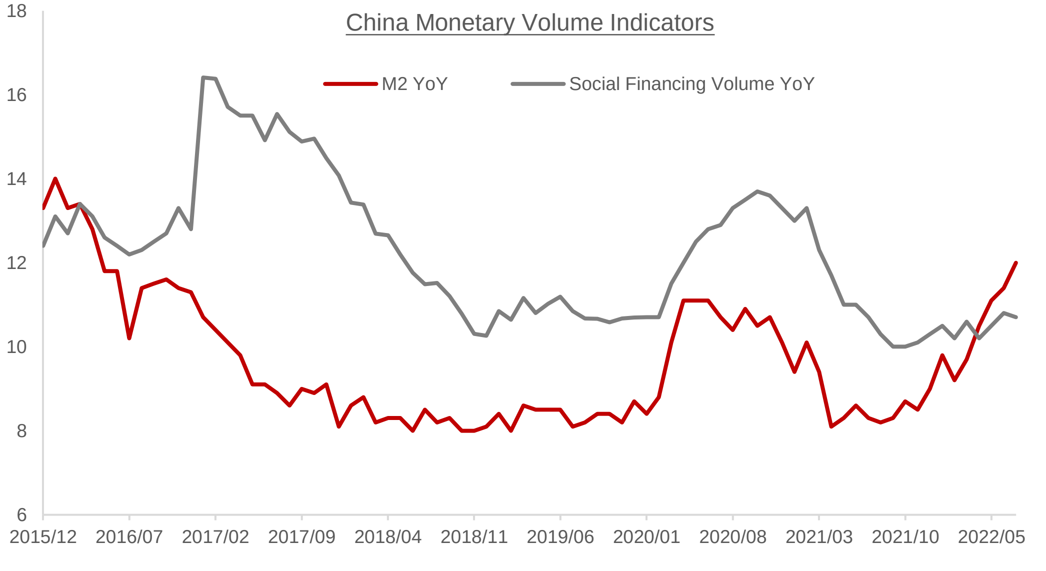

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