Market Insights

June 2022

Equity

MSCI China Index slightly went up by 0.87% in the month of May. The market experienced sharp correction in the first 2 weeks and recovered in the rest time. The Fed increased its benchmark interest rate by 50bps in May FOMC meeting and announced the plan to shrink the balance sheet which caused investors concerns. The rise in new cases as well as the tightening epidemic control measures in Beijing and several other cities triggered investors' worry about the influence of COVID-19 and controls measures on China economic growth again. China equity market started to show resilience from mid-May, as both domestic and external situations improved. As the COVID-19 resurgence in Beijing and other cities has been basically under control and Shanghai was on track to reopen on June 1, the market sentiment markedly improved. Although the economic growth and corporate earnings are under pressure in 2Q due to the COVID-19 resurgence in mainland China, we believe the weakness has been well expected and priced in, especially considering the quite low valuation and high equity risk premium of China equity market. We maintain our long-term positive view on China equity market.

Market Performance

MSCI China Index slightly went up by 0.87% in the month of May. The market trend in May was similar to that in April as the market experienced sharp correction in the first 2 weeks and recovered in the rest time. After the market rebound in late April, China equity market suffered another round of selloff in early May, driven by both external and domestic factors. The Fed increased its benchmark interest rate by 50bps in May FOMC meeting, which was the first time since 2000, and announced the plan to shrink the balance sheet. Although the action was largely within market expectation, investors concerned about further tightening and the negative impacts on valuation and growth prospects, which led to risk-off and correction in global risky asset markets. Domestically, while the number of confirmed positives and asymptomatic cases in mainland China continued to decline, the rise in new cases as well as the tightening epidemic control measures in Beijing and several other cities triggered investors' worry about the influence of COVID-19 and controls measures on China economic growth again. Besides, RMB continued to depreciate against USD in early May due to China's weakening short-term economic fundamentals and the strong USD Index.

China equity market started to show resilience from mid-May, as both domestic and external situations improved. As the COVID-19 resurgence in Beijing and other cities has been basically under control and Shanghai was on track to reopen on June 1, the market sentiment markedly improved as investors agreed with "the short-term worst is over" though held different views on the later recovery trajectory. Also, more policy support was seen in later May, as Premier Li Keqiang called for more efforts to stabilize economy, Vice Premier Liu He met with tech executives and showed support for the development of digital economy, the PBoC surprisingly cut the 5-yr LPR by 15bps, and Premier Li Keqiang held a nationwide videoconference and announced a series of both fiscal and monetary pro-growth policies, etc. Externally, the disappointing earnings of several US retailing giants together with several US macro indicators increased investors' worry on the recession risks and lowered the rate hike expectations. The correction of USD Index since mid-May, combined with China's improving economic fundamentals, significantly eased the depreciation pressure of RMB and HKD.

Data Source: unless otherwise specified, the data in this report extracted from Bloomberg and Winds, as of 31 May 2022.
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Equity

Greater China Indices	May Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	4091.52	1.87	-17.18	3757.09	5334.49
MSCI China	70.39	0.87	-16.49	58.68	111.10
HSI	21415.20	1.54	-8.47	18235.48	29394.69
HSCEI	7416.75	1.62	-9.95	6051.62	10990.63
Global Indices					
S&P 500	4132.15	0.01	-13.30	3810.32	4818.62
Dow Jones Industrial Average	32990.12	0.04	-9.21	30635.76	36952.65
Nasdaq Composite	12081.39	-2.05	-22.78	11035.69	16212.23
FTSE 100	7607.66	0.84	3.02	6787.98	7687.27
DAX 30	14388.35	2.06	-9.42	12438.85	16290.19
Nikkei 225	27279.80	1.61	-5.25	24681.74	30795.78

Economic Data

China's manufacturing PMI rebounded to 49.6 in May from 47.4 in April, and beat the market consensus of 49.0, reflecting that the worst of Omicron drag and lockdown disruptions is over. All key components showed noticeable increases compared to the particularly weak April readings. The non-manufacturing PMI rebounded to 47.8 in May from 41.9 in April, as service PMI rose by 7.1ppt to 47.1 led by the improvement in logistics, financial services and communications. The construction index edged down mildly by 0.5ppt to 52.2, but remained in the expansionary territory. We expect the improving trend to continue in June, with Shanghai's reopening, less Omicron drag in other cities, and the stronger nationwide stimulus.

Future Outlook

Looking forward, we maintain our long-term positive view on China equity market. Although the economic growth and corporate earnings are under pressure in 2Q due to the COVID-19 resurgence in mainland China, we believe the weakness has been well expected and priced in, especially considering the quite low valuation and high equity risk premium of China equity market. Meanwhile, the earnings expectation has been revised down to a relatively reasonable level, as most China Internet companies delivered better-than-feared 1Q results and 2Q guidance in May. Overseas volatility on tightening and recession fears, and China's economic recovery trajectory will be the major short-term influencing factors of China equity market in the coming months.

We expect China's stock market to have three phases in the future. The core elements in the short term are the ease of the epidemic in China, the gradual return of the economy to a normal state, and the implementation of pro-growth policies to drive the economic recovery; the core element in the medium term is the completion of the preparation of China's epidemic prevention and control toolbox , and then the Chinese government can adjust the measures of epidemic prevention and control, so that epidemic prevention and control will no longer have a big impact on economic operation; the long-term core elements are China's internal reform and the improvement of the external environment such as Sino-US relations.

Considering that there is still great uncertainty in the market in the short term, we will continue to maintain a balanced allocation between value stocks and growth stocks, and will continue to pay attention to China's pro-growth policy implementation and its effects, the US liquidity tightening process, China-US relations, and the situation in Russia and Ukraine, the situation of the 25th anniversary of Hong Kong's return to the motherland.

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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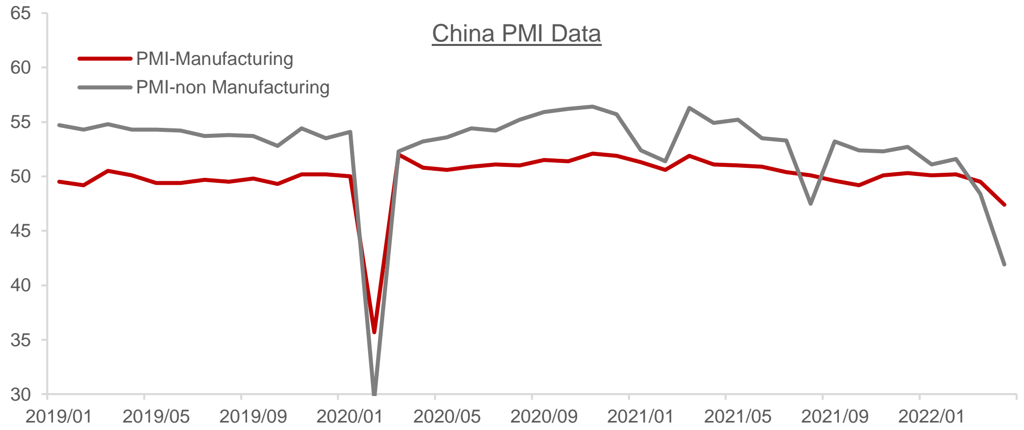

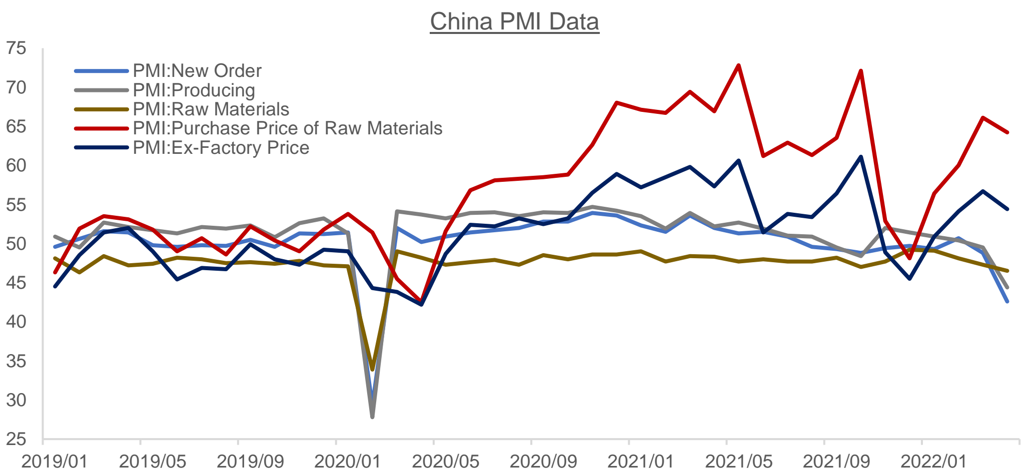

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May was yet another month in which investors needed to sail through the troubled waters, against the headwind of elevated global inflation levels. Nonetheless, by the end of the month, as the Fed indicated some moderation in stance and China's alleviation of the Covid outbreak, most risk assets rebounded. For corporate bonds, volatilities were still elevated, but declining rates supported the overall performance. In China's USD bond market, Investment grate bonds displayed lower volatilities than their peers in other emerging markets. In the high yield space, with some developers extending or defaulting on their obligations, bond prices have fallen again. Since the start of the year, the global economic landscape entered a paradigm shift, from the previous state with low inflation and low interest rate, into the current environment with high inflation and high interest rate. The markets seem to have gone through a stage of declining asset prices, while transitioning to the stage of declining profit margins. For corporate bonds, we are expecting spreads to oscillate in a bounded range, until changes take place in the Fed's stance or the direction of capital flows. Therefore, at the current stage, short-duration and high-grade assets remain the reasonable choice of investment.

Market Performance

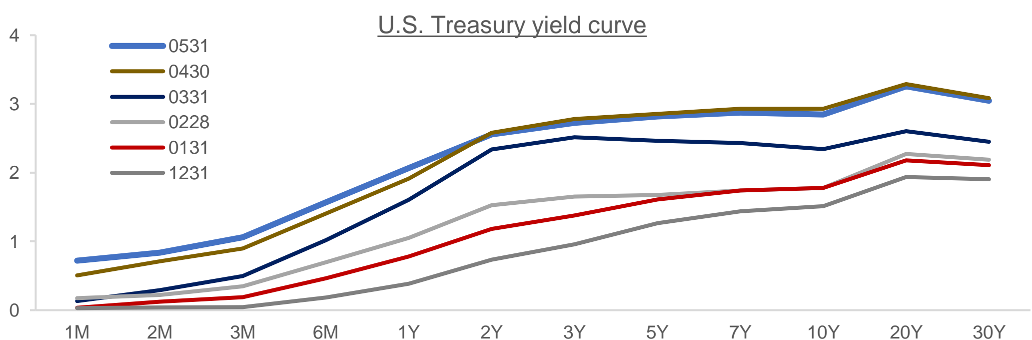
May was yet another month in which investors needed to sail through the troubled waters, against the headwind of elevated global inflation levels, hawkish central banks, and suboptimal economic data. The May FOMC meeting hiked the interest rate by 50 bps as expected, and announced June as the starting month for the Fed's balance sheet normalization. Faced with record-breaking inflationary pressure in the Euro zone, the ECB turned hawkish and suggested a possible rate hike in July. The 10-year US Treasury yield broke over 3.1% early in May, and gradually declined as buyers were drawn for risk-off and allocation bets, with market-expected rate hike levels of the year showing some moderation. With the 2-year US Treasury yield declining by 16bps, the curve bull steepened over the month. During early to mid-May, global markets continued the risk-off tone as seen in April: U.S. equity declined by seven consecutive weeks since April, with the dollar index nearing 105. Nonetheless, by the end of the month, as the Fed indicated some moderation in stance and China's alleviation of the Covid outbreak, most risk assets rebounded. In particular, crude oil outperformed as tensions between Europe and Russia on energy issues intensified.

United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	2.56	-16	182	0.14	2.85
5Y	2.82	-14	155	0.60	3.11
7Y	2.87	-11	143	0.89	3.20
10Y	2.84	-9	133	1.13	3.20
30Y	3.05	5	114	1.66	3.31

China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.39	18	-6	2.18	2.86
5Y	2.54	15	-4	2.34	3.03
7Y	2.77	11	-4	2.61	3.16
10Y	2.80	9	2	2.68	3.18
30Y	3.26	-1	-6	3.22	3.80

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	(0.07)	-2	2	-0.15	-0.01
5Y	0.01	-1	8	-0.14	0.08
7Y	0.13	0	19	-0.14	0.19
10Y	0.24	1	17	0.00	0.30
30Y	1.03	5	34	0.62	1.11

Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	0.50	24	112	-0.79	0.53
5Y	0.83	16	129	-0.78	0.89
7Y	0.93	16	128	-1.15	0.99
10Y	1.12	18	130	-0.52	1.19
30Y	1.38	29	118	-0.13	1.40



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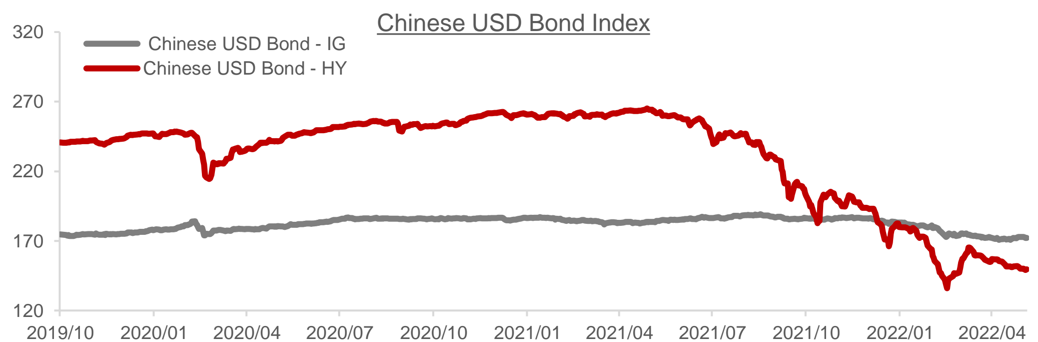
For corporate bonds, volatilities were still elevated, but declining rates supported the overall performance. Following global risk appetite, credit spreads widened during early to mid-May, with capital outflows from the emerging markets. By the end of the month, spreads tightened overall, especially in developed markets. In China's USD bond market, new issue activities were still muted. Investment grate bonds displayed lower volatilities than their peers in other emerging markets. By month-end, as market risk sentiment improved with China's resumption of economic activities, long duration names attracted investors, and LGFV bonds also had solid demand, especially in the shorter tenors. In the high yield space, despite the rollout of various supportive policies, real estate sales continued to drop during the Covid lockdown. The liquidity situation was further strained for many developers, with some companies extending or defaulting on their obligations. Although some high quality private developers, supported by policy accommodation, may be able to restart financing from the public market, overall normalization of market financing for the property sector was still nowhere in sight, and the sector saw another dip over the month. In May as a whole, China's investment grade bonds were up by 0.1%, and China's high yield names declined by 6.8%.

CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	80	(4)	30	46	93
HY CDX	461	(0)	168	269	536
EM CDX	272	(13)	120	146	352
Bond index					
ICE Asian Dollar Corporate	429	-0.5%	-9.5%	425	495
ICE China Issuers Dollar IG Corporate	202	0.1%	-7.2%	200	222
ICE China Issuers Dollar HY Corporate	201	-6.8%	-30.2%	174	431
ICE US Corporate	3115	0.5%	-11.9%	3051	3587
ICE US High Yield	1456	0.3%	-7.8%	1405	1580
ICE Emerging Markets Corporate	411	-0.3%	-12.7%	406	485
Bloomberg Global-Aggregate	474	0.3%	-11.1%	466	550
Bloomberg Global-Aggregate 1-3 Year	171	0.7%	-5.4%	169	187



Economic Data

Inflation remained in the spotlight for economic data. While U.S. inflation in April showed some signs of peaking, price levels in Europe were still under very high inflationary pressures. As for economic activities, weakened economic momentum was indicated by data such as consumer confidence and housing, which led to more concerns over a potential economic recession.

In China, economic impact of the lockdown was palpable: export/import statistics and PMI data weakened substantially, and total social financing was also notably below expectation. To mitigate potential economic downside risks, policymakers decided on more relaxations, as the PBoC lowered the 5-year LPR rate by 15bps.

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Outlook

Since the start of the year, the global economic landscape entered a paradigm shift, from the previous state with low inflation and low interest rate, into the current environment with high inflation and high interest rate. The markets seem to have gone through a stage of declining asset prices, while transitioning to the stage of declining profit margins. Inflation remained high, whereas economic data in many countries showed some signs if weakening. Considering the side effects of the deluge of ultra-monetary easing during the pandemic as well as the structural disruptions in the global supply chains due to the ongoing Russo-Ukrainian War, we find that this round of rate hikes is significantly different from previous ones. The pace of rate hikes and balance sheet normalization is much faster, and risks remain for a potential stagflation or recession scenario. Despite rebounds for some assets in May and contemporaneous capital inflows to emerging markets and risk assets, current risk appetite still has not been fundamentally restored, with the overall outlook still uncertain. The Fed now prioritizes combating inflation as its primary objective, although a substantial portion of high inflation stems from supply-side strains. Therefore, the effects of rate hikes are primarily on the demand side. Meanwhile, China's absence in kickstarting and leading global economic recovery this year, together with its adamant Covid policy, further complicates global economic and inflation conditions. Against this backdrop, it is more challenging for central banks to balance the trade-off between combating inflation and avoiding a possible recession. Moreover, after the FOMC meeting, some Fed officials expressed hawkish positions and suggested that 50bps hikes would not be enough. From a technical perspective, currently the dollar index and the 10-year Treasury yield are both at a pivotal point after climbing from the lower levels to recent peaks: if a downward break is to occur, then risks will be alleviated, which is good news for risk assets. Yet if we see a break to the upside from current levels, then risk assets will likely come under pressure again, even potentially in peril of further downside adjustments that could be larger than the corrections so far this year.

For corporate bonds, following the rebound in risk assets at month-end, spreads did not change much throughout the month of May for most assets. Since the start of this year, new issue activities lagged behind those from the previous two years. Based on current economic conditions, we see valuations approaching the level of reasonableness, albeit still not cheap. That being said, given that the market has relatively well priced its expectations, if a tail risk scenario does not occur in the future, we are expecting spreads to oscillate in a bounded range, until changes take place in the Fed's stance or the direction of capital flows. Therefore, at the current stage, short-duration and high-grade assets remain the reasonable choice of investment. In China, salient factors include the mainland's eventual control of the Covid wave, China's relatively independent policy relaxations, onshore shortage for high quality assets, and price differentials between onshore and offshore assets. Based on these considerations, SOEs, financials, and LGFVs are expected to demonstrate more resilience compared to assets in other economies. For the property sector, under the impact of positive factors such as the control of Covid and lending rate drop, it still remains to be seen whether sales numbers will show signs of rebound. Moreover, we also need to observe whether high quality private developers will be able to rejuvenate financing activities under policy support. Therefore, we still remain cautious for the property sector's overall outlook.

For RMB assets, onshore liquidity remains accommodative, while shortage of onshore high-quality assets tends to exacerbate. If credit financing does not show apparent improvement and economic recovery lags behind expectations, financing rates and credit spreads are expected to oscillate at the currently low levels, although the likelihood for further dips is limited due to constraints such as external conditions. For the currency, the RMB and USD showed some diversion in May, and future two-way moves are expected until a clear turning point for economic fundamentals. If the dollar index breaks higher than previous peaks under accentuated rate-hike expectations, the yuan's spot rate will be notably under pressure against the dollar, and a further upward break past 6.8 remains a possibility. Nonetheless, given the PBoC's not-yet-utilized policy tools and relatively sufficient policy leeway, the chances of the RMB's value to drastically spiral down against a basket of currencies are still minuscule.

Fixed Income

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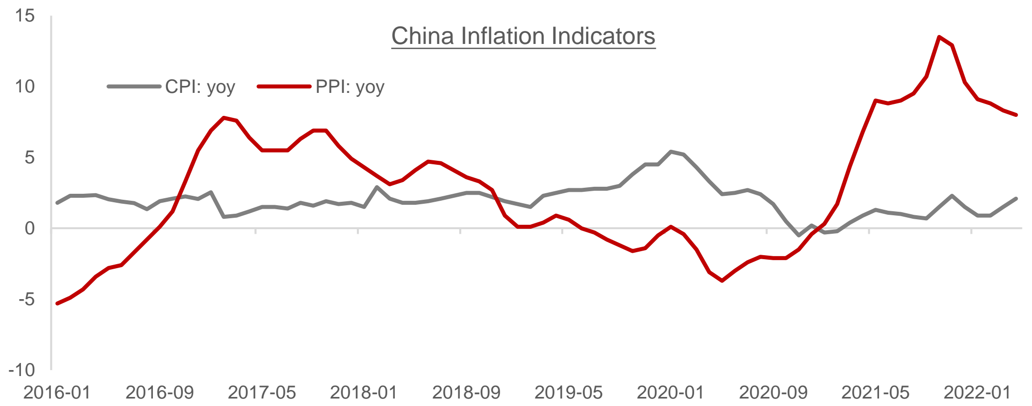

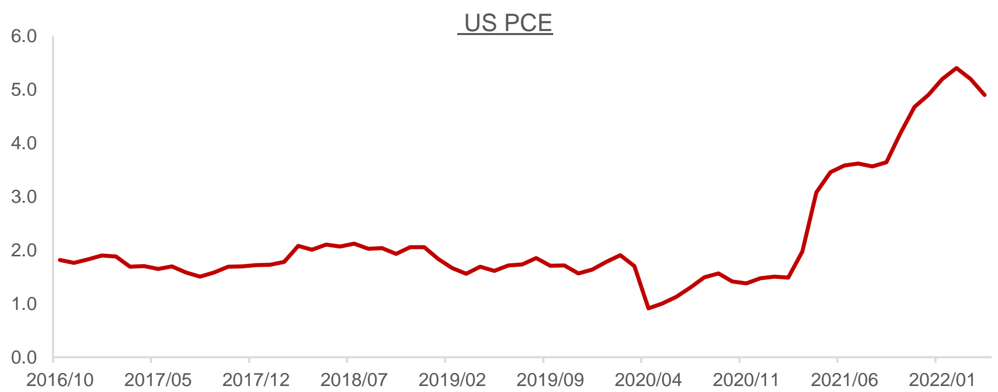

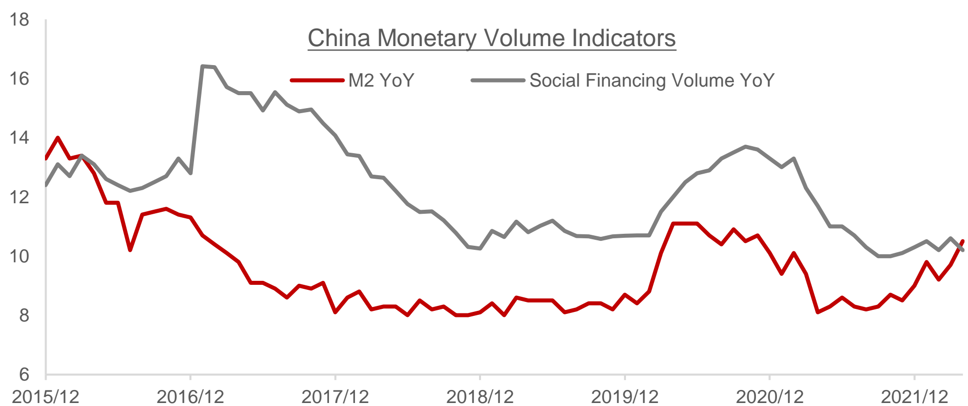

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