Market Insights

October 2022

Equity

MSCI China index dropped by 14.71% in the month of September, and underperformed other major equity markets, mainly driven by the hawkish Fed rate hike outlook, weaker global growth outlook and elevated geopolitical concerns. The offshore RMB exchange rate against USD broke the 7.2 mark in the last week of the month and hit the lowest level since early 2008. Geopolitical concerns continued to dampen the performance of equity market, including the US Senate Committee on Foreign Relations' passage of the Taiwan Policy Act, the elevated Russia-Ukraine situation, and the Europe's energy crisis. Besides, the UK's massive tax cuts further fueled the panic in late Sep, though the conditions temporarily eased after the announcement of UK's bond purchase program. China's Aug macro data suggested the economic recovery was still underway albeit weak. More positive signs emerged in late Sep as a series of policies efforts was put forward to stimulate China's lukewarm property market. Looking forward, we maintain our long-term positive view on China equity market. In the near term, we expect the relatively high market volatility to continue, due to the weak economic recovery in China, ongoing geopolitical concerns, and global rate hike worries. More pro-growth policies are in need to stabilize the economic growth and rebuild the market confidence. In terms of portfolio positioning, we will pay more attention to the quality names with strong cash flows and highly visible earnings growth in current volatile market and continue to seek a balance between value and growth.

Market Performance

MSCI China index dropped by 14.71% in the month of September, and underperformed other major equity markets, mainly driven by the hawkish Fed rate hike outlook, weaker global growth outlook and elevated geopolitical concerns. The higher-than-expected US CPI in August and thereafter the more-hawkish-than-expected rate hike outlook triggered the sharp rise of US Dollar and the bond yields, which led to investors' risk-off globally and depreciation of most currencies against US Dollar. The offshore RMB exchange rate against USD broke the 7.2 mark in the last week of the month and hit the lowest level since early 2008. PBoC announced to reimpose the 20% reserve requirement ratio for FX derivative sales effective from Sep 28. Also, PBoC published a statement on a FX market self-regulatory framework meeting and sent verbal guidance against the rapid depreciation of RMB. Geopolitical concerns continued to dampen the performance of equity market, including the US Senate Committee on Foreign Relations' passage of the Taiwan Policy Act, the elevated Russia-Ukraine situation, and the Europe's energy crisis. Besides, the UK's massive tax cuts further fueled the panic in late Sep, though the conditions temporarily eased after the announcement of UK's bond purchase program. The first batch of China ADR's audit document inspections started in mid-Sep and the results should be available before the end of 2022.

Internally, China's both COVID conditions and economic data marginally improved in Sep. The number of daily new cases in mainland China dropped to below 1000 and the cities running >10 cumulative new cases accounted for about 20% of China's GDP in late Sep vs. over 30% in early Sep. The relaxation of inbound restrictions in HK and Macau rekindled investors' expectation of China's reopening after the Party Congress in Oct. China's Aug macro data suggested the economic recovery was still underway albeit weak. More positive signs emerged in late Sep as a series of policies efforts was put forward to stimulate China's lukewarm property market.

Equity

Greater China Indices	Sep Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	3804.89	-6.72	-22.98	3757.09	5143.84
MSCI China	57.21	-14.71	-32.13	56.58	96.88
HSI	17222.83	-13.69	-26.39	17016.28	26234.94
HSCEI	5914.08	-13.85	-28.20	5835.34	9397.95
Global Indices					
S&P 500	3585.62	-9.34	-24.77	3584.13	4818.62
Dow Jones Industrial Average	28725.51	-8.84	-20.95	28715.85	36952.65
Nasdaq Composite	10575.62	-10.50	-32.40	10565.13	16212.23
FTSE 100	6893.81	-5.36	-6.65	6787.98	7687.27
DAX 30	12114.36	-5.61	-23.74	11862.84	16290.19
Nikkei 225	25937.21	-7.67	-9.91	24681.74	29960.93

Economic Data

China's manufacturing PMI increased to 50.1 in Sep from 49.4 in Aug, back to the expansionary territory after 2 months of contraction and better than market consensus of 49.7. The new order sub-index rose further to 49.8 in Sep from 49.2 in Aug, and the output sub-index improved to 51.5 in Sep from 49.8 in Aug. The manufacturing sectors recovered on improved weather conditions and continued policy support. The non-manufacturing PMI fell to 50.6 in Sep from 52.6 in Aug, driven by deterioration in services sectors due to protracted Covid restrictions. The services sub-index fell to 48.9 in Sep from 51.9 in Aug, while the construction sub-index rose notably to 60.2 in Sep from 56.5 in Aug thanks to ongoing fiscal stimulus.

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 relatively high market volatility to continue, due to the weak economic recovery in China, ongoing geopolitical concerns, and global rate hike worries. More pro-growth policies are in need to stabilize the economic growth and rebuild the market confidence. Also, the geopolitical tensions, the economic status of the developed markets, and the attitudes of global central banks may bring more uncertainties to equity markets.

In terms of portfolio positioning, we will pay more attention to the quality names with strong cash flows and highly visible earnings growth in current volatile market and continue to seek a balance between value and growth. We will closely monitor the upcoming 20th Party Congress, China's pro-growth policies, the progress of China's economic recovery and the development of external uncertainties.

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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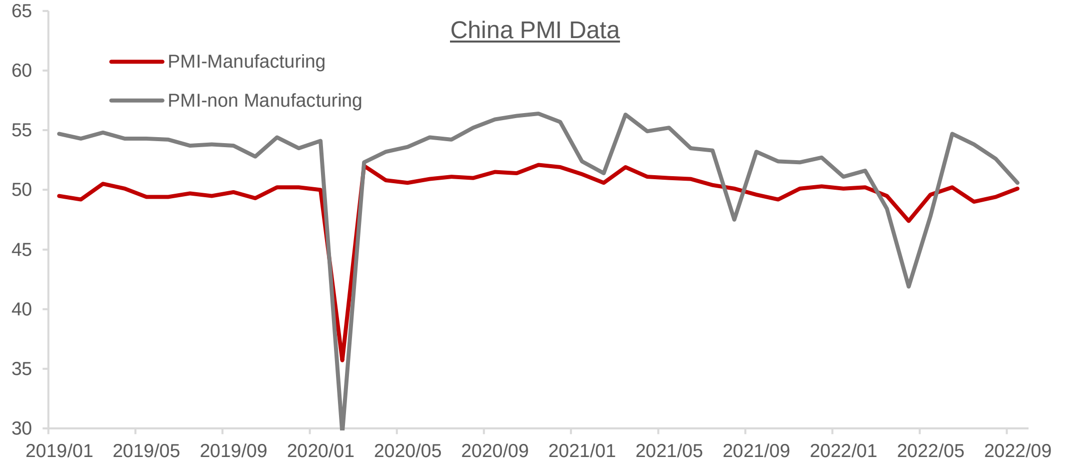

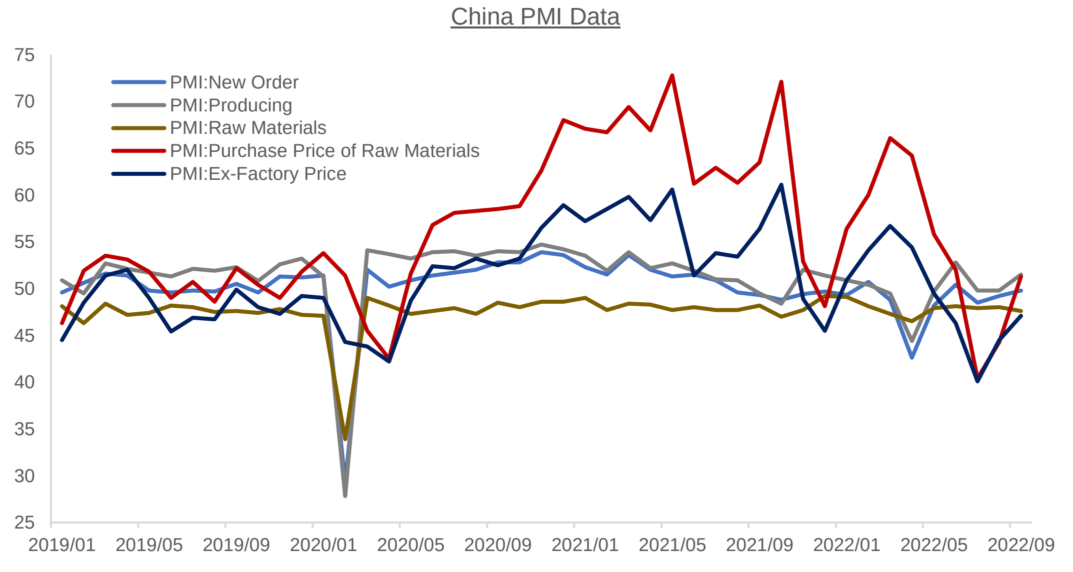

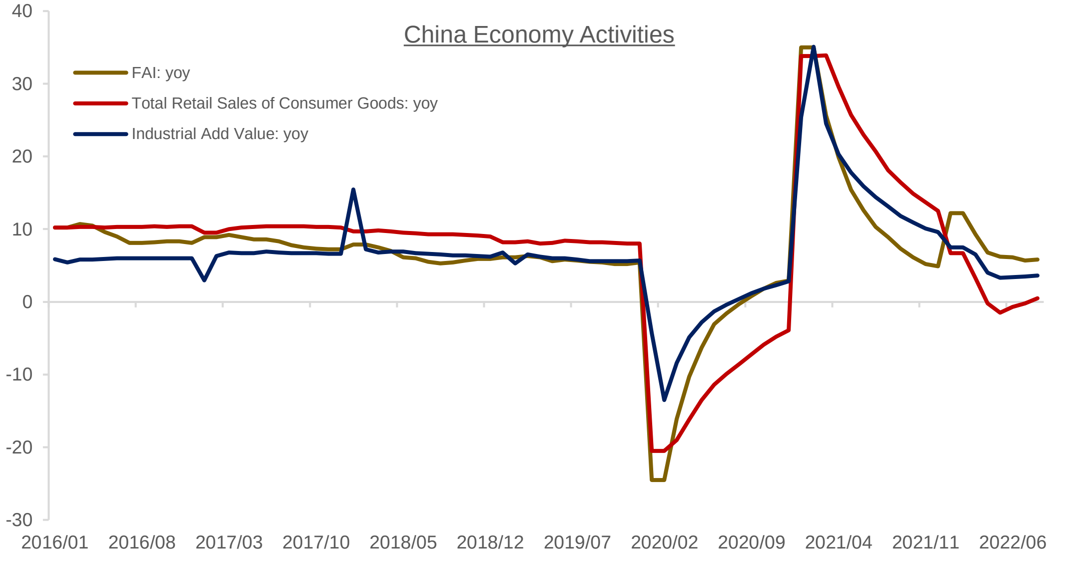

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Markets went down in September. Starting the month, the Fed's increasingly hawkish signals continued to put pressure on asset prices. Risk appetite remained subdued, against the backdrop of high levels of inflation, escalation of the Russian-Ukrainian War, and controversial fiscal policies in the UK. Most assets declined in value, except for the dollar. The Hang Sang Index, Nasdaq, and crude oil were among the worst performers. Following overall market sentiment, rates rose and credit spreads widened in tandem. For Chinese USD bonds, the investment grade space remained resilient, supported by technical factors. U.S. economy still has not entered an actual recession as indicated by economic data while Europe may be the most problematic region in terms of economic conditions. In China, although the Covid control measures remained strict, economic data still showed some recovery. As for U.S. rates, we are looking at an upward path, with some corrections to steepen the curve along the away. In Europe, the central bank is expected to maintain a hawkish stance by necessity, while most currencies such as the euro, sterling, and yen are still expected to be under pressure. China's high yield property sector crashed again. If property sales remain sluggish, the liquidity issues would still be problematic given the current policy support to private real estate companies. It remains to be seen whether there will be sizable policy support to the property market after the 20th Nation Congress.

Market Performance

Markets went down in September. Starting the month, the Fed's increasingly hawkish signals continued to put pressure on asset prices. Risk appetite remained subdued, against the backdrop of high levels of inflation, escalation of the Russian-Ukrainian War, and controversial fiscal policies in the UK. After the 75bp rate hike in September's FOMC meeting, markets re-priced the length and destination of the hiking cycle. As global liquidity continued to tighten, most countries' government bond yields climbed higher. Over the month, U.S. Treasury yields continued to surge, with the 2-year yield rising by 29bps to 4.28%. The 10-year yield climbed by 64bp to 3.83%, while also breaking above 4% at some point near month-end in response to the surge in Gilt yields. Most assets declined in value, except for the dollar. The Hang Sang Index, Nasdaq, and crude oil were among the worst performers.

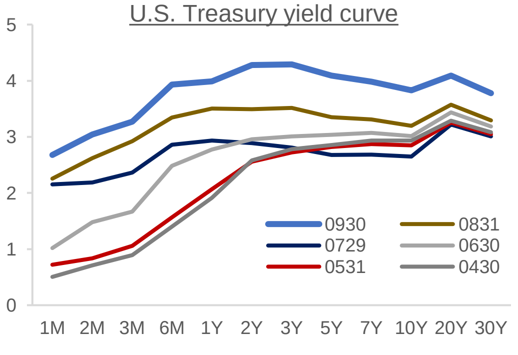
United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	4.28	79	355	0.28	4.35
5Y	4.09	74	283	0.94	4.25
7Y	3.98	67	254	1.26	4.18
10Y	3.83	64	232	1.33	4.02
30Y	3.78	48	187	1.66	3.90

China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.32	14	-13	2.14	2.74
5Y	2.57	17	-1	2.34	2.89
7Y	2.75	13	-6	2.58	3.02
10Y	2.75	11	-3	2.61	3.05
30Y	3.19	8	-14	3.08	3.59

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	(0.05)	3	4	-0.13	0.00
5Y	0.07	6	14	-0.11	0.12
7Y	0.19	5	25	-0.11	0.32
10Y	0.24	2	17	0.04	0.32
30Y	1.39	20	70	0.65	1.52

Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	1.76	56	238	-0.79	2.03
5Y	1.96	57	242	-0.66	2.24
7Y	1.99	61	234	-1.15	2.24
10Y	2.11	57	229	-0.41	2.35
30Y	2.09	47	190	-0.13	2.24

U.S. Treasury yield curve



10-year U.S. Treasury yield

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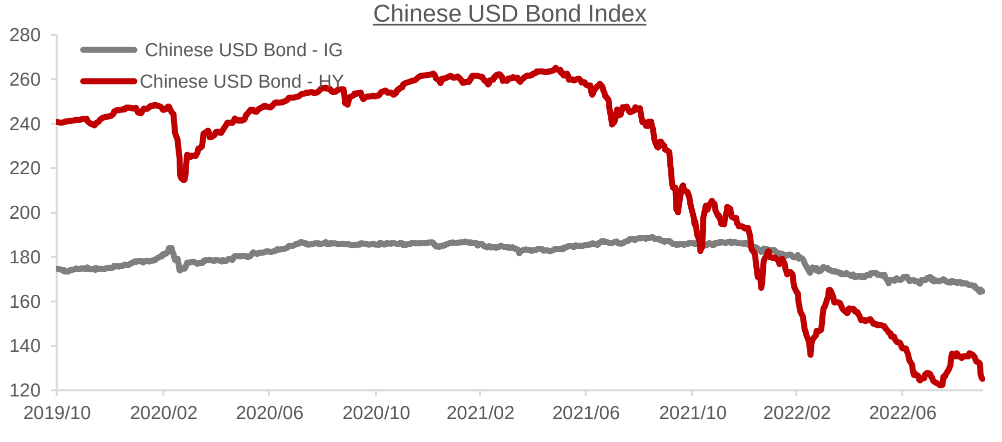
Following overall market sentiment, rates rose and credit spreads widened in tandem. The credit spreads for most region by month-end had been close to or exceeded the highs at the end of June. For Chinese USD bonds, the investment grade space remained resilient, supported by technical factors. In the first half of the month, credit spreads for high quality banks and SOEs tightened towards year-to-date lows, and widened to some extent at month-end following weakness in China’s equity and currency market. The AMC and LGFV sectors were under pressure in comparison.

CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	108	16	58	49	114
HY CDX	610	77	317	285	640
EM CDX	331	4	179	174	395
Bond index					
ICE Asian Dollar Corporate	402	-3.7%	-15.2%	401	479
ICE China Issuers Dollar IG Corporate	193	-2.4%	-11.5%	193	219
ICE China Issuers Dollar HY Corporate	152	-13.5%	-47.5%	149	329
ICE US Corporate	2886	-5.3%	-18.3%	2875	3576
ICE US High Yield	1348	-4.0%	-14.6%	1345	1580
ICE Emerging Markets Corporate	382	-4.4%	-18.9%	382	474
Bloomberg Global-Aggregate	427	-5.1%	-19.9%	421	540
Bloomberg Global-Aggregate 1-3 Year	160	-2.7%	-11.6%	159	183



Economic Data

U.S. inflation data in August once again exceeded market expectations, as the persistence of inflation from the service sector makes it hard for inflation to fall. The slight cool-down of jobs data for August did not affect the Fed’s adamant policy direction. Other data also beat expectations for the most part, such as PMI, consumer confidence, and housing, meaning that the U.S. economy still has not entered an actual recession. In Europe, the energy crisis and political conflicts remain thorny issues, while high levels of inflation and sluggish PMI data only made matters worse. From this perspective, Europe may be the most problematic region in terms of economic conditions.

In China, although the Covid control measures remained strict, economic data still showed some recovery.

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Outlook

The rapid pace of global liquidity tightening sent shockwaves across markets in September. Although the Fed is more than halfway through the rate-hike process, the accumulation of risk is gradually spilling over to other countries, including emerging markets, making risk assets sustain pressure and volatility during this process. Global inflation is expected to be persistent, and markets may only have short term rebounds when the rate-hike process is impacted by notable weaking in economic data such as employment, PMI, consumption and housing. As for U.S. rates, we are looking at an upward path, with some corrections to steepen the curve along the away. With the overall yield curve deeply inverted, the 10-year yield is now at a central level of 3.85 to 4, and will have the chance to break upwards over 4 once the 2-year yield breaks over 4.5. In Europe, the central bank is expected to maintain a hawkish stance by necessity, while political segmentation within the region could continue to cause market rupture. The temporary asset purchasing plan by the Bank of England is more about the signal than the actual effects, while most currencies such as the euro, sterling, and yen are still expected to be under pressure.

In the credit market, most sectors came close to year-to-date lows by the end of September, sitting around the 75% percentile in the five-year span. From the yield perspective, current valuations offer some attractiveness, with some technical rebounds on the table in the short run. However, during the remainder of the year, it is likely for credit spreads and spreads across credit ratings to experience volatility and widen. It would be wise to control and diversify credit risks, and maintain a certain level of liquidity to prepare for good buys when markets continued to slide down. The Chinese USD bond market continued a relatively independent performance, with China's investment grade sector being the only one having a mostly flat credit spread so far this year. Liquidity remains abundant in the Hong Kong market, although it is necessary to be cautious of the rising capital costs and related shocks to high-beta bonds with weak credit profile and structure. China's high yield property sector crashed again. If property sales remain sluggish, the liquidity issues would still be problematic given the current policy support to private real estate companies. It remains to be seen whether there will be sizable policy support to the property market after the 20th Nation Congress.

China's economy remains under pressure. Despite healthy levels of inflation, consumption and corporate borrowing are still weak. Fiscal pressures are notable in some regions. Further monetary relaxation is limited by the global environment with rate hikes across the board. Policy directions on the property sector and pandemic control measures are among the deciding factors on whether the economy can have a substantial recovery. For RMB assets, our portfolio has sufficient cash and liquidity, which enables dip-buying as markets move in across stages. The yuan liquidity is expected to be abundant, but with large sums of matured MLFs in the fourth quarter, if the central bank continues to supply liquidity via open market operations instead of lowering the reserve rate, the money market rates could still climb up. As the domestic economy shows weak recovery and the yuan faces episodic pressure, the mid to long term yields are expected to continue facing volatility. Recently the central bank utilizes numerous methods to enhance its support to the yuan exchange rate, and with the falling of the dollar index, yuan's one-sided depreciation has been subdued to some extent. In the fourth quarter, China's export growth rate is likely to keep falling, but trade surplus remains at high levels. As the economy recovers marginally, the yuan is expected to be stable against a basket of currencies, with the dollar index being the deciding factor for yuan's future directions.

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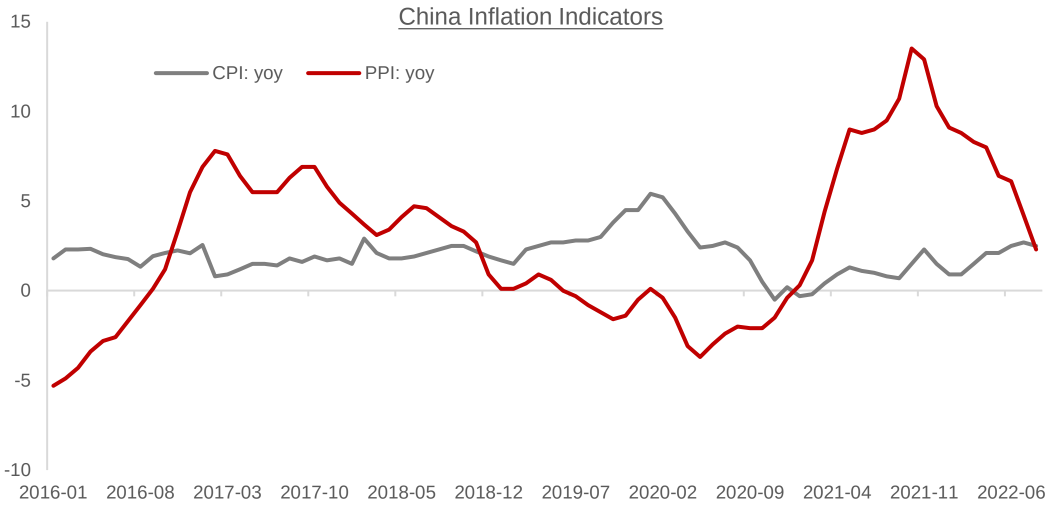

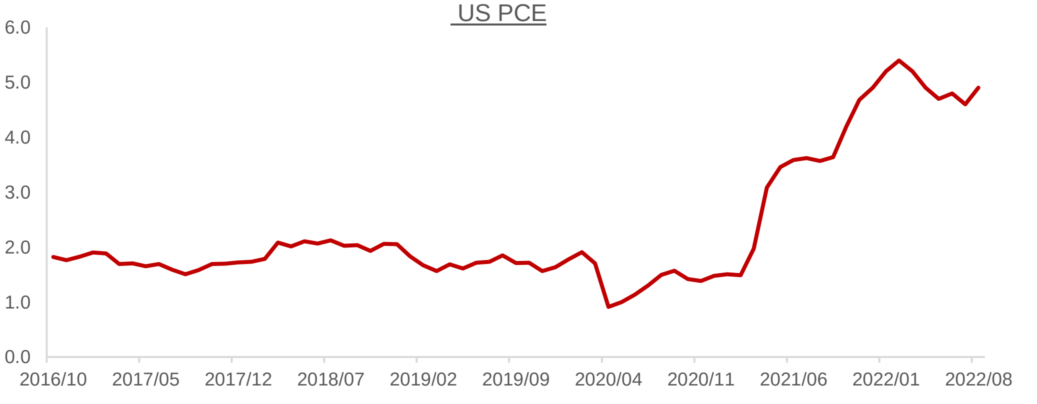

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