Market Insights

March 2023

Equity

MSCI China index declined by 10.24% in the month of February, mainly driven by a significant reversal in the US disinflation trend, re-escalated US-China tensions, and lowered expectations on the "Two Sessions". The China economic recovery process continued in February, with mobility, logistics, dining and construction operation rates largely back to normal. We maintain our long-term positive view on China equity market. The February PMI indicates China economy is well on its way to recover as output, demand and sentiment continues to improve. We will continue to seek a balance between value and growth. We continue to focus on the long-term policy beneficiaries (eg. software localization and advanced manufacturing), short-term policy beneficiaries (property and property-related sectors) and reopening-related opportunities (eg. consumer, Internet, financials and healthcare). Also, we will prudently pay attention to some thematic investment opportunities.

Market Performance

MSCI China index declined by 10.24% in the month of February, mainly driven by a significant reversal in the US disinflation trend, re-escalated US-China tensions, and lowered expectations on the "Two Sessions", despite moderate economic recovery in mainland China and generally positive 4Q22 results reported by China's Internet names. The changes in the external environment were the dominant factor behind the sharp correction in China's equity market this month, with offshore China equity market which is more vulnerable to external factors significantly underperforming China A-share market. Sector wise, telecommunications, energy, utilities led, while IT, healthcare, and consumer discretionary lagged.

The China economic recovery process continued in February, with mobility, logistics, dining and construction operation rates largely back to normal. Encouragingly, the 70-city primary home price finally turned flat sequentially in January, after 16 consecutive months of declines, With continuous policy support and gradually improving market confidence, property sales picked up in February and the YoY growth turned positive. 4Q22 results reported by China's Internet names are generally positive, demonstrating the impact of platform companies' efficiency improvement and overall faster-than-expected economic recovery in mainland China. However, most China Internet names didn't perform well after earnings announcements, as some investors chose to take profit given the re-escalated US-China tensions and the rising US bond yields.

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Equity

Greater China Indices	Feb Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	4069.46	-2.10	5.11	3495.95	4539.39
MSCI China	64.96	-10.24	0.76	47.43	77.48
HSI	19785.94	-9.41	0.02	14597.31	22700.85
HSCEI	6581.47	-11.36	-1.84	4919.03	7918.12
Global Indices					
S&P 500	3970.15	-2.61	3.40	3491.58	4637.30
Dow Jones Industrial Average	32656.70	-4.19	-1.48	28660.94	35492.22
Nasdaq Composite	11455.54	-1.11	9.45	10088.83	14646.90
FTSE 100	7876.28	1.35	5.70	6707.62	8047.06
DAX 30	15365.14	1.57	10.35	11862.84	15658.56
Nikkei 225	27445.56	0.43	5.18	24681.74	29222.77

Economic Data

China's manufacturing PMI rose to 52.6 in February from 50.1 in January, reaching the highest level since Apr 2012 and indicating a broad-based post-COVID uptick in economic activity. The new order sub-index rose to 54.1 in February from 50.9 in January, and the output sub-index jumped to 56.7 in February from 49.8 in January, suggesting stronger demand and further production normalization. The non-manufacturing PMI increased to 55.6 in February from 54.4 in January, showing further solid recovery with strengthening momentum beyond the Lunar New Year festival season. The services sub-index rose further to 55.6 in February from 54.0 in January, and the construction sub-index rose further to 60.2 in February from 56.4 in January.

Future Outlook

Looking forward, we maintain our long-term positive view on China equity market. The February PMI indicates China economy is well on its way to recover as output, demand and sentiment continues to improve. However, PBoC seems more cautious on further RRR&LPR cuts in the near term due to strong credit growth and better-than-expected property sales in 1Q23. Premier Li announced a GPD growth target of "around 5%" for 2023 in the Government Work Report, which is reasonable but slightly less ambitious than the "above 5%" or "5%-5.5%" discussed by some investors. However, China government remain focused on growth with a larger official fiscal deficit of 3% of GDP, more SLGB insurance, and still accommodative monetary policy. The press conference to be held by the new government leaders on Mar 13 may convey more forward-looking policy clues.

We will continue to seek a balance between value and growth. We continue to focus on the long-term policy beneficiaries (eg. software localization and advanced manufacturing), short-term policy beneficiaries (property and property-related sectors) and reopening-related opportunities (eg. consumer, Internet, financials and healthcare). Also, we will prudently pay attention to some thematic investment opportunities, including the ChatGPT/AI and SOE re-rating.

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; China's economy recovers less than expected after the directional adjustment of policy.

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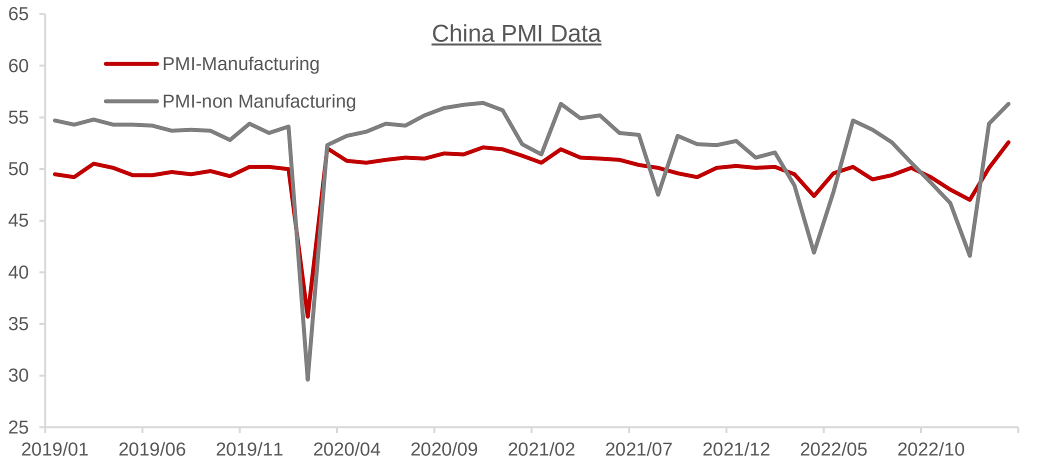

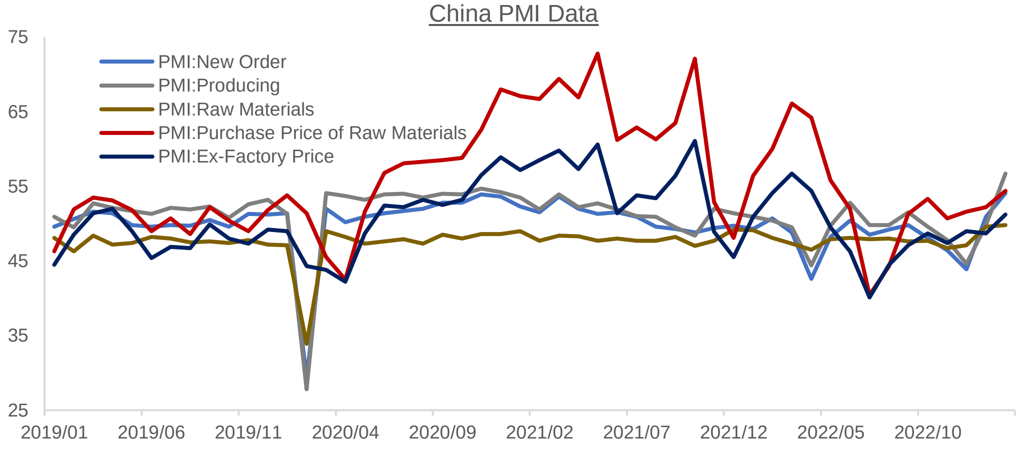

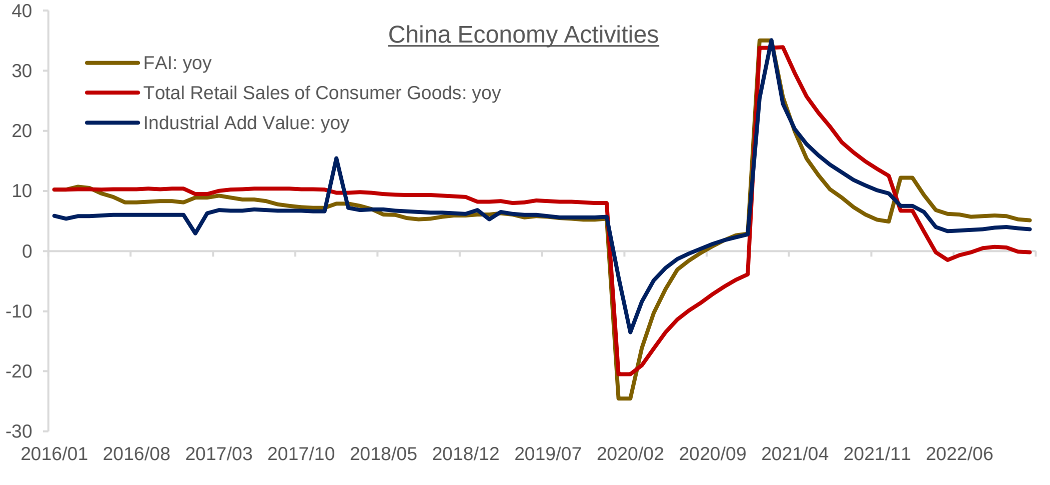

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In February, as U.S. economic data such as CPI and employment overshot expectations, the "higher for longer" theme returned to financial markets, and the dollar index climbed up again. Moreover, deterioration in China-U.S. relations and Russo-Ukrainian conflicts further quenched risk appetite in global markets. For corporates, bond prices fell in response to the rise in Treasury yields, conceding most of the price pick-ups this year so far. However, on a spread basis, most regions and sectors remained resilient. In U.S., some market participants discussing the possibility of a non-landing this year. Speeches from Fed officials maintained a hawkish stance. In China, economic activities picked up notably after the pandemic, with strong economic indicators. For U.S. rates in the short run, yields could persist to be traded at elevated levels. However, in the medium-to-long term, the terminal rate may reach the peak.

Market Performance

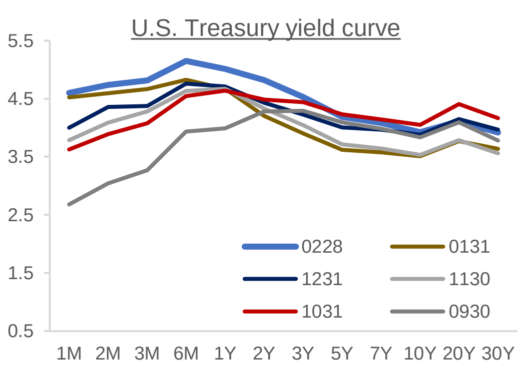
In February, as U.S. economic data such as CPI and employment overshot expectations, the "higher for longer" theme returned to financial markets, and the dollar index climbed up again. Moreover, deterioration in China-U.S. relations and Russo-Ukrainian conflicts further quenched risk appetite in global markets. Despite the Fed's slowing of rate-hike pace to 25bp in February, market-implied rate hike end point climbed by 50 bps over the month to near 5.5%, with the probability of rate cuts this year declining. U.S. Treasury yields climbed up over the month, with the 2-year yield making new highs since 2007 levels, and the curve inversion continued to exacerbate. Most risk assets saw corrections, with the correlation between bonds and equity remaining close. European assets outperformed relatively, while commodities lagged in performance.

United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	4.82	61	39	1.42	4.94
5Y	4.18	56	18	1.55	4.50
7Y	4.08	51	12	1.62	4.44
10Y	3.92	41	5	1.67	4.34
30Y	3.92	28	-5	2.11	4.42

China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.57	5	15	2.14	2.57
5Y	2.72	2	9	2.36	2.77
7Y	2.86	0	4	2.58	2.91
10Y	2.92	1	8	2.61	2.96
30Y	3.30	#VALUE!	10	3.08	3.42

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	(0.03)	-2	-7	-0.11	0.07
5Y	0.22	2	-2	-0.04	0.34
7Y	0.43	2	-2	-0.01	0.58
10Y	0.51	1	8	0.14	0.58
30Y	1.38	-23	-24	0.82	1.72

Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	3.14	49	37	-0.79	3.32
5Y	2.74	43	16	-0.41	2.90
7Y	2.68	41	11	-0.33	2.82
10Y	2.65	37	8	-0.10	2.77
30Y	2.61	39	6	0.10	2.71



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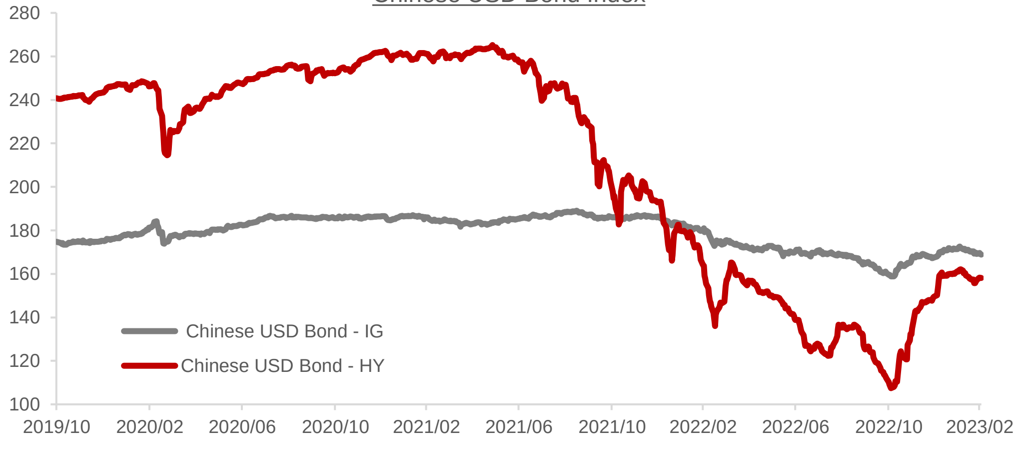
For corporates, bond prices fell in response to the rise in Treasury yields, conceding most of the price pick-ups this year so far. However, on a spread basis, most regions and sectors remained resilient. In the developed markets, new issue activities are bubbly, albeit overall duration sitting on the short side. Capital outflows were seen in emerging markets and high yield bonds. In Chinese USD bonds, technical factors still supported investment-grade spreads to keep tightening in the first half of the month, followed by some widening as market sentiment varied. Over the month, the Chinese USD bonds still outperformance relative to other markets. The real estate sector saw some corrections after three months of surging, with profit taking being one of the factors. Overall, Chinese investment-grade USD bonds fell by 1.3% in February, and high-yield bonds went lower by 3.4%.

CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	76	5	(6)	64	114
HY CDX	463	33	(21)	354	640
EM CDX	241	19	89	205	395
Bond index					
ICE Asian Dollar Corporate	423	1.6%	1.5%	384	448
ICE China Issuers Dollar IG Corporate	199	1.3%	1.0%	185	211
ICE China Issuers Dollar HY Corporate	209	3.4%	8.2%	115	233
ICE US Corporate	3014	2.9%	0.9%	2809	3329
ICE US High Yield	1438	1.3%	2.6%	1345	1508
ICE Emerging Markets Corporate	405	1.9%	1.1%	373	433
Bloomberg Global-Aggregate	445	3.3%	-0.2%	416	511
Bloomberg Global-Aggregate 1-3 Year	167	2.1%	-0.4%	159	177

Chinese USD Bond Index



Economic Data

U.S. non-farm payroll data for January far exceeded expectations, and inflation data such as CPI, PPI, and PCE surprised markets to the upside as well. Other indicators such as consumption, housing, and PMI also point to strong resilience in the U.S. economy, with some market participants discussing the possibility of a non-landing this year. Speeches from Fed officials maintained a hawkish stance.

In China, economic activities picked up notably after the pandemic, with strong economic indicators. In the Eurozone, data shows that the services sector is stronger than manufacturing, and consumer confidence also recovered.

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Outlook

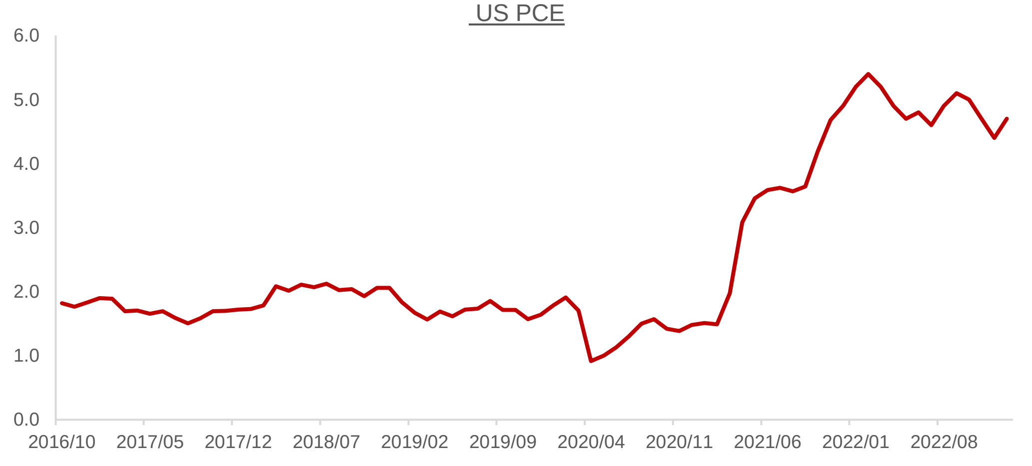
As we had expected, during the month of February, markets corrected on the overly-optimistic prior expectation on the end of the rate-hike cycle. Economic data released this month pointed to a very resilient U.S. economy. Inflation is poised to risks to the upside again, with China's better-than-expected economic recovery being one of the factors. The strength of the U.S. labour market remains unchanged, while structural issues on the supply side led to strong demands in the low-income job markets, and income on some parts of the population increased. Therefore, consumption is boosted, and the price levels in the services sector overshot expectations for both CPI and PMI prints. Meanwhile, the Fed's hawkish stance has not changed in essence, but markets gradually came to brace with the possibility of the return of a 50bp hike as economic data rolled out. Although trading a hawkish Fed could still be a major theme in the markets in the short run, as some leading economic indicators weaken and the non-linear impact of the rate hikes to the economy becomes palpable, we think a "non-landing" is not likely in this rate-hike cycle. On the contrary, the risk remains for a deeper recession in the future. Therefore, for U.S. rates in the short run, yields could persist to be traded at elevated levels; however, in the medium-to-long term, as the terminal rate materializes, recession expectations and selling pressure could push the 10-year yield back to the 3.6% area. With economic and inflation situation in Europe mirroring that of the U.S., the higher rate-hike expectations in the U.S. could offer some leeway for the ECB's tightening policies. In Japan, the new BoJ governor still appeared dovish in his speeches, although the country is still widely expected to end its yield curve control policy by the end of this year.

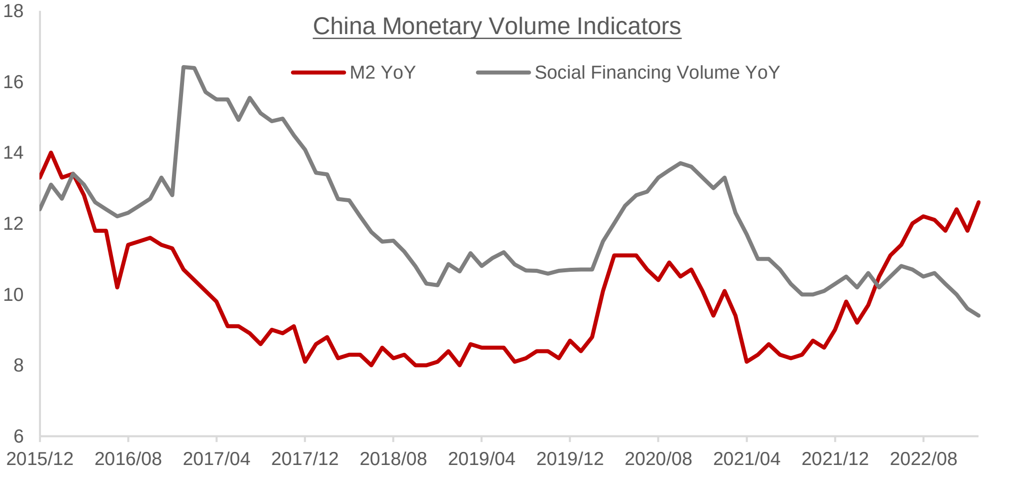
For corporate bonds, the current condition is different from the previous two rounds of rate hikes, in which yields and spreads quickly moved upwards in tandem. Currently, although risk appetite fell to some extent, the rapid rise in yields in February did not lead credit spreads to move wider. On a spread basis, the USD bonds in most regions and countries remain pricey. We remain cautiously optimistic, expecting the U.S. economy to show some resilience in the short run, and high coupon yields could offer some assurance of returns. In the medium term, however, macro risks such as China-U.S. relations, Russo-Ukrainian conflicts, and the weakening of U.S. economy could put pressure on corporate fundamentals and cause credit spreads to widen. Therefore, we remain cautious on credit duration and credit risk. For Chinese USD bonds, the market has been trading outside of fair valuations, as high quality names enjoy substantial support on the technical side, while tail risks remain for the LGFV space. For the property sector, home sales showed some good recovery, especially in the pre-owned market. Yet it still takes time for cash flow to go back to the property developers. Moreover, as the Chinese economy recovered more strongly than expected, the government could exercise some restraint in its support to the property sector. Property bond prices are trading a relatively normal levels after substantial rebounds.

Recently there was greater volatility in terms of the yuan's liquidity, as markets became more reliant on the central banks' liquidity injection. The excess reserve ratio goes lower amid economic recovery and credit expansion. Meanwhile, variability on banks' balance sheets and mounting maturities of deposits put pressure on interbank financing, with long-term money market rates making new highs. With economic recovery being the set course, markets disagree on the strength of the recovery, and recovery in the real estate sector is a paramount factor for financing needs of households. Recent high frequency data indicates that pre-owned home sales are showing signs of recovery. If the economic recovery is able to persist and lift up the sales of new homes, then medium-to-long term yields could climb higher. On the contrary, if housing sales and investment stay at the bottom, interest rates could still trade within current ranges.

The dollar index continued to rebound, climbed up to 105 last week, and fell in response to China's stronger-than-expected PMI data. The yuan was resilient following the PMI data release, after some prior depreciation in response to geopolitical risks such as the Russo-Ukrainian War and China-U.S. relations. The yuan's index against a basket of currencies was close to 101. China's Two Sessions, which started in the past weekend, set the 2023 GDP target to 5%, falling at the lower end of mainstream expectations, which could put pressure on risk sentiment and the yuan.

That being said, recent data shows a strong economic recovery, indicating robust fundamentals for the yuan. Moreover, China's manufacturing new orders climbed back above 50 for the first time since mid-2021, which is surprising given the backdrop of shrinking global demand. Meanwhile, South Asian countries including Thailand, India, and Vietnam also have better-than-expected PMI data, and the BDI index continued to rebound. These indicators might imply that global demand is better than expectation. China's February trading data released this weak could offer some additional explanation for the demand in exports. Considering the correlation between PMI items and the yuan's exchange index, we expect the RMB to maintain its strong performance.





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