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ChinaAMC (HK)

MARKET INSIGHTS

Finding value amid China's policy tailwinds

April 2023

Equity

The MSCI China Index rose by 4.50% in March, mainly due to a stable global financial environment in late March, China's support for the internet industry, and easing geopolitical factors. China's Manufacturing PMI decreased from 52.6 in February to 51.9, indicating a slower recovery in the manufacturing industry. However, the Non-Manufacturing PMI rose to 58.2, reflecting a steady recovery in household consumption and tourism-related spending. We maintain a positive long-term outlook for the Chinese stock market. The Chinese economy's fundamentals remain strong, and structural policies are expected to continue to strengthen. Improved liquidity expectations after a decrease in expectations of a US Federal Reserve interest rate hike are also favorable for the valuation levels of the Chinese stock market.

Market Performance

MSCI China index rose by 4.50% in the month of March, thanks to stabilizing global financial conditions, China's further support to the Internet sector and easing geopolitics in late March. The market corrected in the first several weeks of the month due to China's slightly less ambitious GDP growth target, investors' lower expectation on China's stimulus policy and concerns over global financial stability. In late March, following the stronger-than-expected earnings from Tencent and Jack Ma's return to China, Alibaba and JD.com surprised the market by unveiling a significant overhaul of their businesses and the investors warmly welcomed these moves.

Meanwhile, the optimistic outlook portrayed by Premier LI Qiang during a keynote speech at the Boao Forum for Asia also restored market confidence. Premier LI pointed out that the momentum and trend of China's economic growth are strong, and new measures will be introduced in areas such as expanding market access, optimizing the business environment, ensuring project implementation, and constantly optimizing the institutional environment for state-owned enterprises, private enterprises, and foreign enterprises to take risks and invest.

Greater China Indices	Mar Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	4050.93	-0.46	4.63	3495.95	4530.33
MSCI China	67.88	4.50	5.29	47.43	77.02
HSI	20400.11	3.10	3.13	14597.31	22700.85
HSCEI	6968.86	5.89	3.94	4919.03	7918.12
Global Indices					
S&P 500	4109.31	3.51	7.03	3491.58	4593.45
Dow Jones Industrial Average	33274.15	1.89	0.38	28660.94	35492.22
Nasdaq Composite	12221.91	6.69	16.77	10088.83	14534.38
FTSE 100	7631.74	-3.10	2.42	6707.62	8047.06
DAX 30	15628.84	1.72	12.25	11862.84	15706.37
Nikkei 225	28041.48	2.17	7.46	25520.23	29222.77

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Economic Data

China's manufacturing PMI fell to 51.9 in Mar from the 11-year high of 52.6 in Feb, suggesting ongoing recovery in manufacturing sector but at a slower pace. The new order sub-index eased modestly to 53.6 in Mar from 54.1 in Feb, and the output sub-index fell to 54.6 in Mar from 56.7 in Feb. The non-manufacturing PMI increased further to 58.2 in Mar from 56.3 in Feb, reaching the highest reading since May 2011, and showing improvements in both the construction and services sectors. The construction sub-index rose further to 65.6 in Mar from 60.2 in Feb, and the growth of construction sector accelerated in Mar as weather turned warmer. The services sub-index rose further to 56.9 in Mar from 55.6 in Feb, led by strong readings in retail sales. Rail transport, road transport, air transport, highlighting ongoing solid recovery in household consumption and travel-related spending.

Future Outlook

Looking forward, we maintain our long-term positive view on China equity market. The domestic fundamental recovery is still expected to be relatively strong, and structural policies are expected to continue to increase. Improved liquidity expectations will be positive for the valuation of China equity market with lower Fed interest rate hike expectations. Increasing interactions between China's senior officials and executives of foreign companies and the release of Alibaba's landmark restructuring plan in late March both reaffirmed the government's "pro-business" policy tone set at the CEWC last December, while the crackdown on malicious comments that damage the reputation of businesses and entrepreneurs, launched by the cyberspace regulator also showed support for the private sector. We expect policy tailwinds for private companies to continue for the rest of the year, given their primary roles in securing jobs and boosting income 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

Expansion of risk events in the financial systems of European and American countries; 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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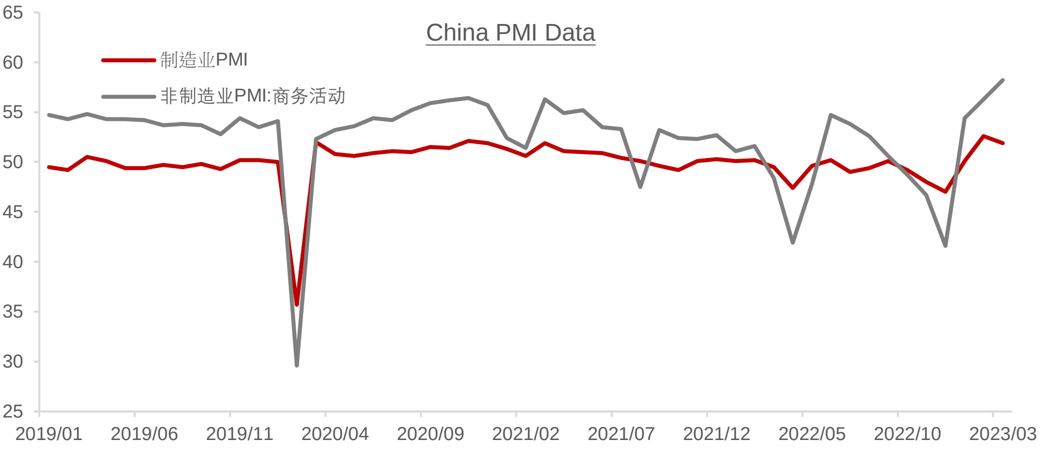

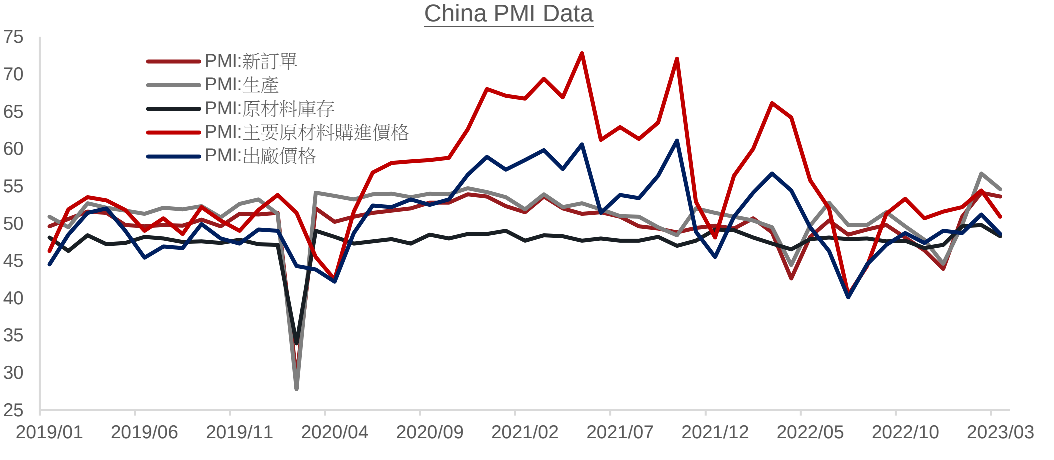

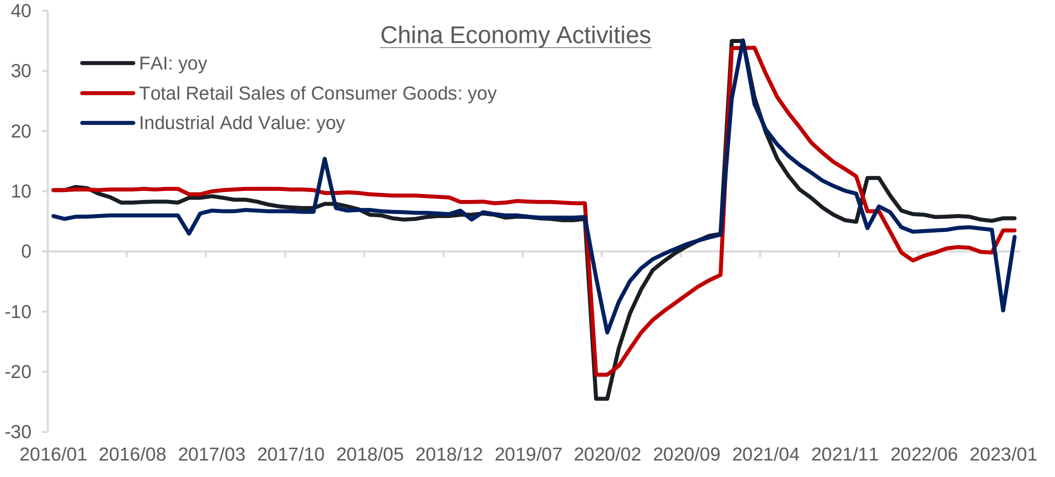

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In March, global financial markets were volatile, but central banks like the US Federal Reserve acted quickly to calm the situation. Economic data was mixed, with non-farm payroll data remaining strong while inflationary pressures eased slightly. The US economy is believed to have short-term resilience but faces an increasing risk of a deep recession. The US Federal Reserve's monetary policy is expected to involve 1-2 interest rate cuts at the end of the year. In China, economic data showed continued recovery in the real estate industry, while European economic activity was relatively strong with high inflationary pressures.

Market Performance

In March, there was significant volatility in global financial markets. The Silicon Valley Bank and Credit Suisse incidents caused concern about the risks facing the banking system in a tightening environment, which led to substantial risk aversion among market participants. U.S. Treasury yields fell across the board, alleviating the curve inversion to some extent, and safe-haven assets such as gold saw significant gains, with a large influx of funds into money market funds. However, the swift response by central banks such as the US Federal Reserve calmed some of the market worries. Combined with the dovish display at the Fed's FOMC meeting, risk appetite gradually improved, and the market priced in a 50-bp rate cut for the year. Overall, despite significant volatility, equity and bond assets still recorded decent single-month returns against the backdrop of expectations that policy rates have peaked.

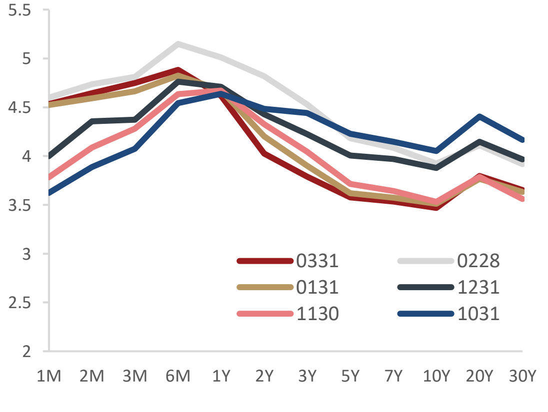
United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	4.03	-79	-40	2.27	5.08
5Y	3.57	-61	-43	2.57	4.50
7Y	3.53	-55	-43	2.56	4.44
10Y	3.47	-45	-41	2.51	4.34
30Y	3.65	-27	-31	2.59	4.42

China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.51	-6	9	2.14	2.57
5Y	2.68	-4	5	2.36	2.77
7Y	2.83	-3	1	2.58	2.91
10Y	2.86	-6	2	2.61	2.96
30Y	3.23	-7	3	3.08	3.37

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	(0.06)	-2	-10	-0.11	0.07
5Y	0.10	-11	-13	-0.04	0.34
7Y	0.23	-20	-22	0.02	0.58
10Y	0.35	-15	-7	0.16	0.58
30Y	1.26	-12	-35	0.93	1.72

Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	2.68	-45	-8	-0.08	3.38
5Y	2.31	-43	-27	0.39	2.90
7Y	2.28	-40	-29	0.45	2.82
10Y	2.29	-36	-28	0.61	2.77
30Y	2.36	-25	-18	0.73	2.71

U.S. Treasury yield curve



10-year U.S. Treasury yield

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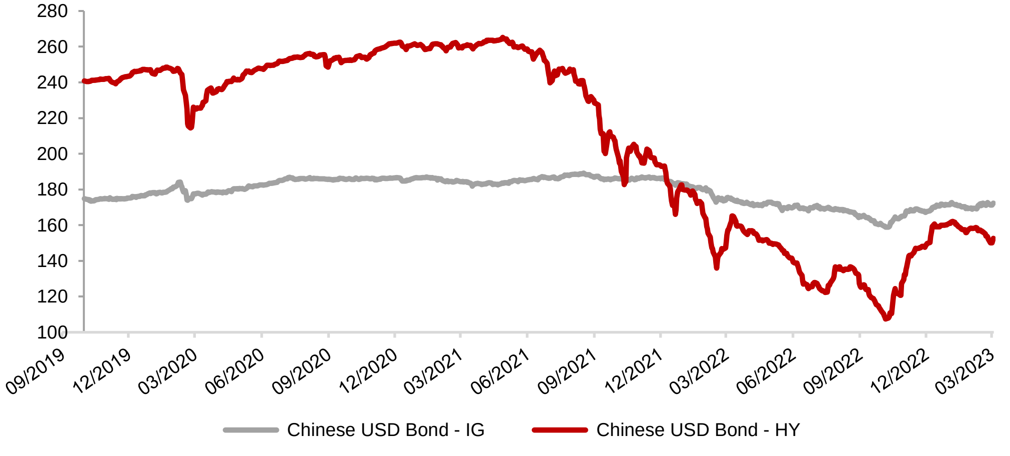
In terms of corporate bonds, the sharp decline in interest rates supported bond prices, and credit spreads experienced significant fluctuations, initially widening with overall risk aversion and then narrowing later on. Overall, the monthly return was flat, with investment-grade bonds outperforming high-yields. European AT1 bonds were heavily impacted by the banking crisis, falling by an average of 15 points before recovering about half of the decline. Chinese investment-grade USD bonds still showed resilience in the context of global markets, with good performance from state-owned enterprises, banks, and technology sectors. High-yield real estate bonds continued to experience declines following the release of poor 2022 financial results and negative news. Overall, Chinese investment-grade bonds rose by 1.4%, while high-yield bonds fell by 5.9%.

CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	76	(1)	(6)	66	114
HY CDX	463	1	(21)	382	640
EM CDX	229	(11)	78	205	395
Bond index					
ICE Asian Dollar Corporate	427	1.0%	2.6%	384	439
ICE China Issuers Dollar IG Corporate	201	1.4%	2.4%	185	205
ICE China Issuers Dollar HY Corporate	196	-5.9%	1.9%	115	233
ICE US Corporate	3091	2.6%	3.5%	2809	3214
ICE US High Yield	1454	1.1%	3.7%	1345	1492
ICE Emerging Markets Corporate	410	1.2%	2.3%	373	424
Bloomberg Global-Aggregate	459	3.2%	3.0%	416	491
Bloomberg Global-Aggregate 1-3 Year	170	2.0%	1.6%	159	174

Chinese USD Bond Index



Economic Data

Overall economic data has been mixed. Non-farm payrolls remain strong despite structural issues, while data such as CPI, PPI, and PCE wages indicate that inflation pressure is easing. Investor and PMI data suggest that the current economy is still resilient, but there is still a large divergence in investor views on the future of the US economy. The banking crisis was a contributing factor to FOMC meeting's change of language to indicate that interest rate hikes are coming to an end, but it reaffirmed its determination to combat inflation.

In China, economic data, including the real estate sector, continued to recover, and European economic activity showed more strength, but inflation pressure remain high. More and more emerging markets have ended this round of interest rate hikes.

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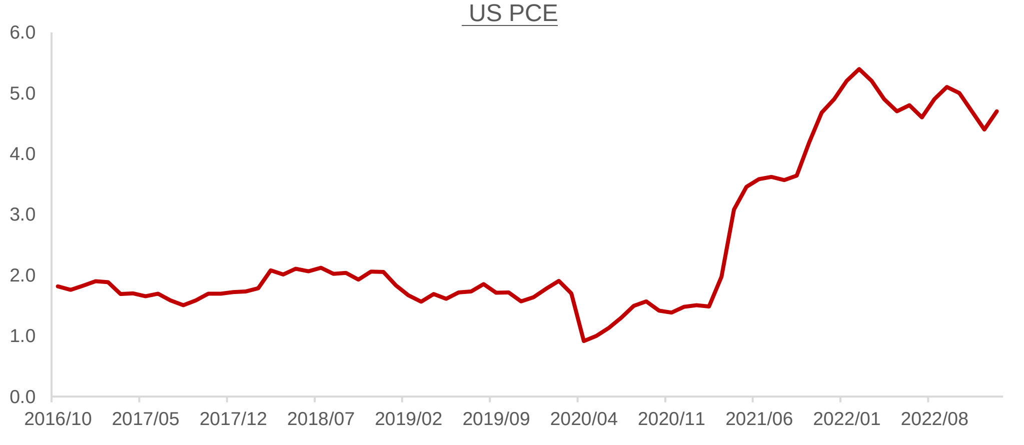
Outlook

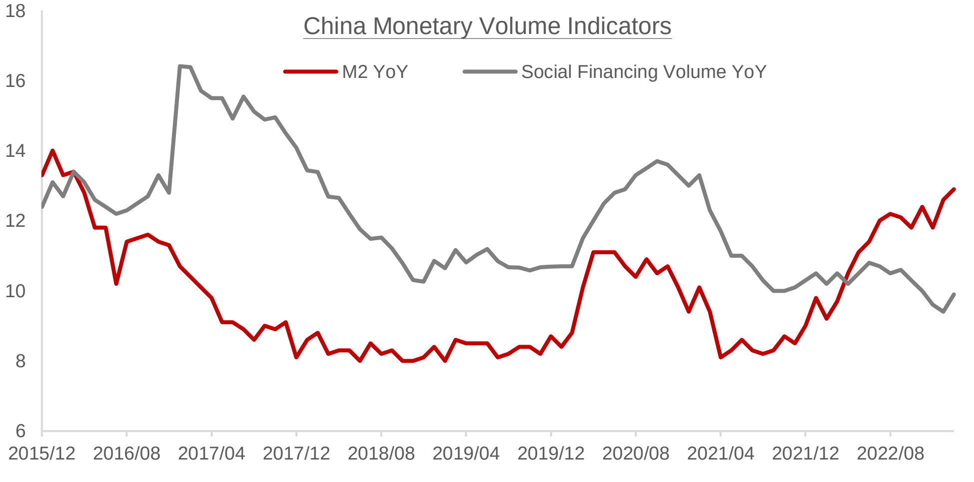
The rapid collapse of Silicon Valley Bank and the acquisition of Credit Suisse by UBS belied the negative impact of this round of rate hikes on the financial system. That being said, the problems with Silicon Valley Bank and Credit Suisse were unique in their own ways. The Fed stabilized investor and depositor concerns about small and medium-sized banks through measures such as the short term credit expansion, while the Swiss National Bank also effectively addressed further transmission of Credit Suisse risk by sacrificing AT1 bond holders' interests. However, we believe that the probability of further bank liquidity crises or financial crises is low. For banks at large, the capital and profitability of global systemically important banks are still sound, and the investment losses on the asset side will gradually ease as interest rates fall. Signs of deposit outflows have already ameliorated significantly. In terms of overall liquidity, the Fed still has sufficient reserves to deal with potential risks, and both the leverage ratio and asset quality and financing costs of residents and enterprises are clearly better than those during the 2008 financial crisis. However, potential risks from US commercial real estate (such as refinancing risk) and asset management companies (such as fund redemption risk) need to be monitored. In terms of US economic inflation, we believe that the US economy still has resilience in the short term, but the risks of deep recession are increasing. Regarding the Fed's monetary policy, although the market has significantly raised pricing for interest rate cuts during the year, we still lean towards "not higher but longer" and maintain our expectation of one or two more cuts by the end of the year. Therefore, if the market further digests the impact of the Silicon Valley Bank and Credit Suisse incidents, and the trend of US bond yields returns to being dominated by economic fundamentals, the curve shape will further normalize as the interest rate hike peaks. Unless there is an extreme risk event, the probability of a significant decline in yields is not great and the yield is expected to trade around the 3.4% level. With the commencement of quantitative tightening by the ECB and the strengthening of the yen, the Fed's decision may open up some space for monetary policy by the ECB and BOJ.

For corporate bonds, despite the significant widening of credit spreads in the first half of the month and peaking in the middle of the month, most regions and sectors still did not break through last year's high, and the credit spread significantly tightened in the latter half of the month following the improvement in risk sentiment. Although historical experience shows that credit spreads will not widen significantly in the three months before and after the interest rate hike peak, considering current valuation levels, we still recommend being cautious and expect more divergence across different sectors and ratings. We prefer to allocate more to A-rated or higher-quality entities. In addition, credit spreads will still have multiple rounds of volatility or widening due to the risk events associated with interest rate hikes this year, and it is possible to add long-term oversold bonds on dips while on overall short-duration allocations. As for Chinese USD bonds, technical support will remain strong until the issuance of high-quality entities returns to normal. Many investors are holding bank capital bonds, state-owned enterprise perpetual bonds, and high-quality short-term LGFV bonds, which will remain relatively stable. In terms of real estate, the overall industry, including sales, continues to recover, but it will still take time to return to normal or reach the profit-loss balance point of private developers. We will closely monitor corporate liquidity conditions and capture relevant opportunities through high-frequency industry data.

Recently under the continuous liquidity inject by the PBoC, the RMB funding market has slightly eased. At the beginning of the month, in the face of continued pressure on the funding market, the central bank successively injected funds through continuous reverse repurchase and MLF, and announced a 0.25% reserve requirement ratio cut in the middle of the month, which to some extent reversed the expectation of upward movement of money market rates. Money market rates at the longer-than-one-month tenors declined by about 10 bps throughout the month. However, looking ahead to April, quarterly tax payment pressures will once again put pressure on the money market, and with the reserve requirement ratio already having been cut, the market will once again depend on injections from the central bank. At the same time, the discount rate for bills continued to rise in March, reflecting elevated credit demand. But with the expectation of strong economic recovery fading, mid-to-long-term bond yields will also be difficult to significantly increase, and short-term rates may continue to fluctuate within a range.

The US dollar index has been weak and volatile. After the outbreak of the US banking crisis, the market once bet that the Fed would change its course. Subsequently, under the rapid intervention of policy makers, the crisis seemed to have temporarily subsided, but the dollar index did not rebound, indicating that the market believed that this banking crisis would lay the groundwork for a recession in the US economy. Meanwhile, China's new social financing, PMI and other leading indicators all point to sustained economic recovery, real estate sales are gradually picking up, and the fundamentals still provide support for the yuan. In the case of a weak dollar, the RMB index is unlikely to carry on the strong performance, but if the dollar continues to weaken and drives the USD/CNY exchange rate below an integer level, a rapid appreciation of the RMB may ensue.





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