ChinaAMC (HK)

MARKET INSIGHTS

Market awaits further policy incentives

June 2023

Equity

In May, the MSCI China index dropped 8.95% due to weakened economic recovery, potential COVID-19 resurgence, and geopolitical tensions. China's macro indicators declined, and loan and credit growth slowed. Manufacturing and non-manufacturing PMIs fell, signaling slower recovery in construction and services sectors. Despite weak economic data, long-term positivity remains for the China equity market. Domestic policy stimulus is anticipated to restore growth momentum, but massive stimulus is unlikely. Upcoming Politburo meeting in late July may bring pro-growth measures. Investment focus includes long-term policy beneficiaries, short-term policy beneficiaries, reopening-related opportunities, and thematic investments like AI and SOE re-rating.

Market Performance

MSCI China index dropped by 8.95% in the month of May, due to the weakened economic recovery, signs of a second COVID-19 wave and geopolitical tensions. Apart from a few consumption-related categories, most macro indicators in China showed sequential declines since April, after the release of pent-up demand in 1Q23. China's loan and credit growth also slowed significantly from 1Q23, likely due to front-loading of loan extensions and weak credit demand. The renewed property distress is leading to worsening funding stress for developers and LGFVs. The Japanese government announced that 23 items, including advanced semiconductor manufacturing equipment, will be added to the list of items subject to export controls, which will make it more difficult for companies to export to China. Signs of US/China resuming communication started to emerge in mid-May, as several government official meetings took place.

Greater China Indices	May Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	3798.54	-5.72	-1.89	3495.95	4530.33
MSCI China	58.59	-8.95	-9.12	47.43	77.02
HSI	18234.27	-8.35	-7.82	14597.31	22700.85
HSCEI	6163.34	-8.04	-8.08	4919.03	7918.12
Global Indices					
S&P 500	4179.83	0.25	8.86	3491.58	4325.28
Dow Jones Industrial Averag	32908.27	-3.49	-0.72	28660.94	34712.28
Nasdaq Composite	12935.29	5.80	23.59	10088.83	13256.21
FTSE 100	7446.14	-5.39	-0.08	6707.62	8047.06
DAX 30	15664.02	-1.62	12.50	11862.84	16331.94
Nikkei 225	30887.88	7.04	18.37	25520.23	32217.43

Economic Data

China's manufacturing PMI fell to 48.8 in May from 49.2 in Apr, mainly due to insufficient demand (especially in chemical fibres, non-metallic mineral products and ferrous metal processing industries). The new order sub-index decreased to 48.3 in May from 48.8 in Apr, and the output sub-index fell to 49.6 in May from 50.2 in Apr. The non-manufacturing PMI moderated to 54.5 in May from 56.4 in Apr, which was still solid but lower than market expectations, suggesting continued recovery in construction and services sectors but at a slower sequential pace. The construction sub-index fell to 58.2 in May from 63.9 in Apr but remained elevated, and the NBS noted that construction enterprises were optimistic about the outlook of construction sector. The services sub-index fell to 53.8 in May from 55.1 in Apr, with the PMIs of service industries such as airlines, ship and road transport services and telecommunication above 60 and the PMI in property sector below 50.

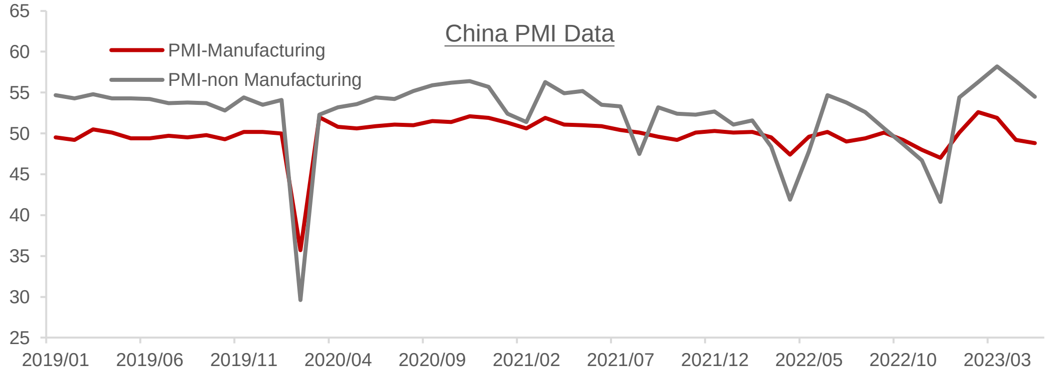
Outlook

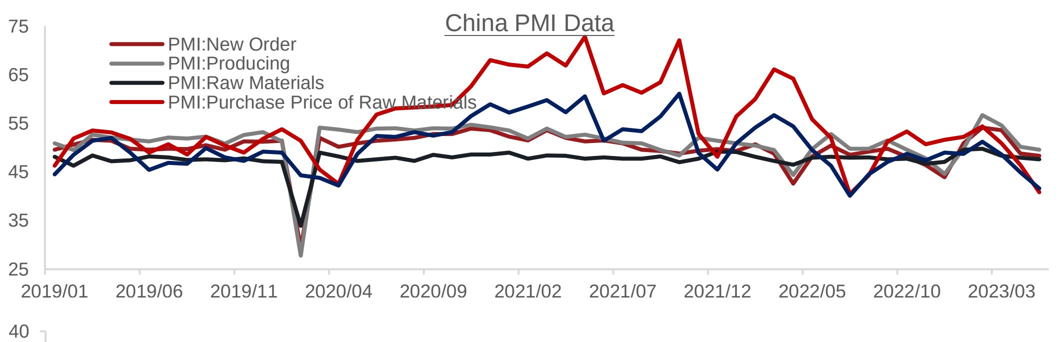
Looking forward, we maintain our long-term positive view on China equity market. A series of weaker-than-expected economic and financial data in recent weeks fueled worries about the strength of China's economic recovery, and sparked anticipation of further domestic policy stimulus (especially over the property sector in major cities) to restore the upward growth momentum. Although domestic policy seems to be reluctant to introduce another round of massive stimulus recklessly, the extremely depressed valuations mean limited downside risks. However, a better domestic growth outlook is still the prerequisite for a more sustainable rally. We will see whether China's high-frequency economic indicators will improve in the coming monthly and whether more pro-growth measures will be rolled out at the Politburo meeting in late July.

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 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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In May, global markets diverged with the US economy outperforming others. US Treasury yields increased while China and Europe faced economic weakness. US dollar and growth stocks performed well; oil underperformed. Bond market performance was impacted by rising interest rates, but Chinese investment-grade bonds outperformed other regions. Uncertainty remained about the US economic outlook. Europe faced inflation and economic growth peaking. Market caution persisted, but US economic data showed strength. Rates are expected to trade within a loose bound before establishing a directional bias. Corporate bonds outlook remains cautiously optimistic amid high coupon environment. In China, SOE credit spreads remained low. Emerging markets displayed varied economic fundamentals, with some warranting caution. Long-term bond allocation presents value, while a dumbbell strategy is advised for the short and medium term.

Market Performance

May saw a divergence in global markets, with the May FOMC meeting hinting at the end of rate hikes, but the stronger economic situation in the United States, relative to other regions, led to an increase in Treasury yields and supported the relative performance of US risk assets. Towards the middle of the month, focus shifted to the debt ceiling, but there was no excessive panic. Despite the alleviation of concerns over regional banks in the United States, China and Europe's economic weakness led to notable contention in global risk appetite. Overall, risk assets' performance was mixed throughout the month, with the US dollar and growth stocks leading the way, while oil underperformed.

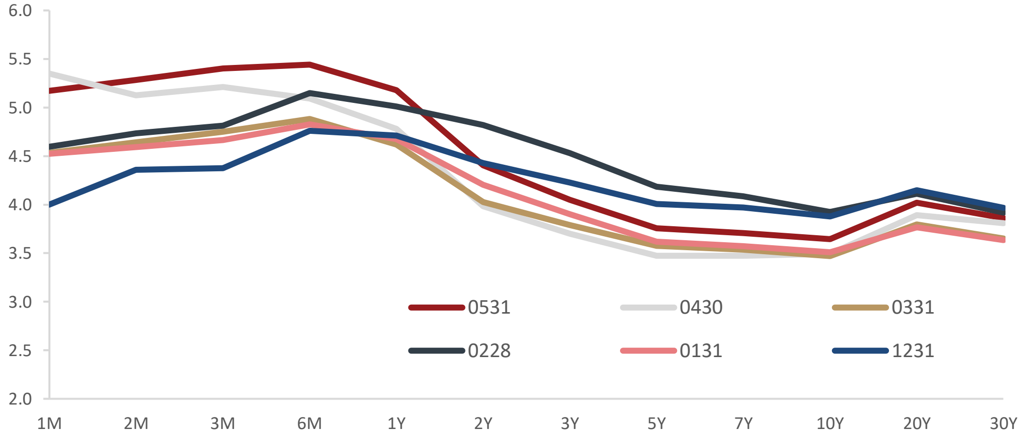
United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	4.40	40	-2	2.65	5.08
5Y	3.75	27	-25	2.58	4.50
7Y	3.70	24	-27	2.56	4.44
10Y	3.64	22	-23	2.51	4.34
30Y	3.86	19	-10	2.85	4.42

China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.28	-17	-14	2.14	2.57
5Y	2.45	-17	-17	2.36	2.77
7Y	2.67	-9	-15	2.58	2.91
10Y	2.71	-7	-13	2.61	2.96
30Y	3.08	-7	-12	3.07	3.34

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	(0.05)	-1	-9	-0.11	0.07
5Y	0.10	-2	-14	-0.04	0.34
7Y	0.23	1	-22	0.02	0.58
10Y	0.44	4	1	0.16	0.58
30Y	1.26	3	-35	1.03	1.72

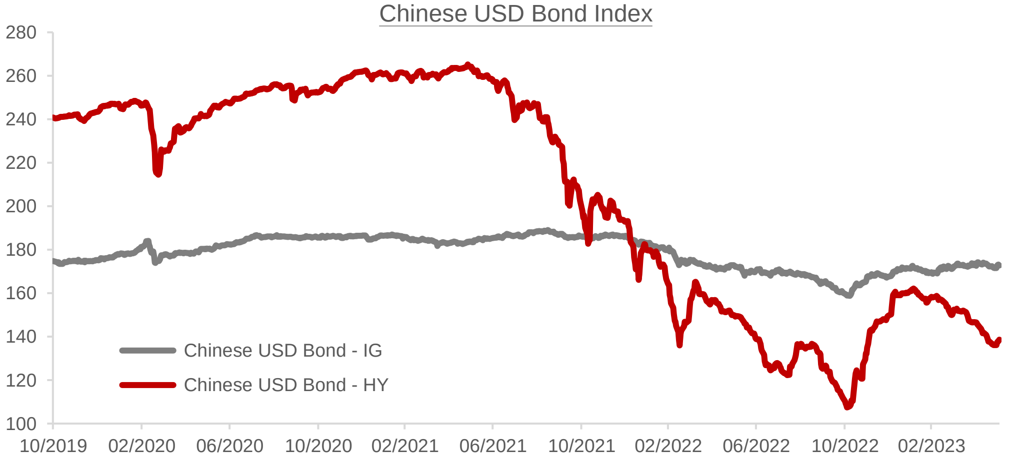
Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	2.72	3	-4	0.17	3.38
5Y	2.28	-3	-30	0.39	2.90
7Y	2.25	-4	-32	0.45	2.82
10Y	2.28	-3	-29	0.68	2.77
30Y	2.46	5	-8	0.95	2.71

U.S. Treasury yield curve



For corporate bonds, global credit spreads initially widened before tightening in May, trading within tight ranges throughout the month. However, the overall performance of the bond market was negatively affected by rising interest rates. Large amounts of new bond issuance from the US were well absorbed by the persistent inflows into investment-grade funds. In the Chinese USD bond market, investors continued to chase long-term, high-quality bonds. Although the domestic economy was not optimistic, support from various technical factors helped Chinese investment-grade bonds outperform other regions. Chinese high-yield bonds traded lower amid weak sales momentum and individual credit negative news.

CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	76	(0)	(6)	66	114
HY CDX	475	9	(9)	400	640
EM CDX	247	9	95	205	395
Bond index					
ICE Asian Dollar Corporate	427	-0.8%	2.6%	384	432
ICE China Issuers Dollar IG Corporate	203	-0.4%	3.0%	185	204
ICE China Issuers Dollar HY Corporate	166	-9.5%	-13.9%	115	218
ICE US Corporate	3076	-1.3%	2.9%	2809	3142
ICE US High Yield	1454	-0.9%	3.7%	1345	1481
ICE Emerging Markets Corporate	410	-0.9%	2.2%	373	417
Bloomberg Global-Aggregate	452	-2.0%	1.4%	416	471
Bloomberg Global-Aggregate 1-3 Year	168	-1.5%	0.4%	159	171



US inflation continued to fall, but there was still some divergence in data from different metrics. A large number of US companies posted better-than-expected first quarter results, and the current economic data still reflected strong resilience. Employment, service sector PMI, housing, and various consumer data all exceeded expectations. However, based on the structure of multiple economic data, there was uncertainty about the outlook for the US economy. The negotiations between Biden and McCarthy over the debt ceiling were complex, but a preliminary agreement was reached at the end of the month. Many Federal Reserve officials released hawkish signals, and expectations for interest rate hikes in June and July returned. China's economic recovery slowed significantly, and Europe's many countries saw inflation continue while economic growth showed signs of peaking.

Outlook

The market maintained a relatively cautious tone since the March banking crisis, although the approaching debt ceiling caused some market volatility. However, with the US economic data consistently stronger than expectations (while the economic data of non-US economies was weaker than expected), the US dollar index rebounded, and several major asset classes reached key levels that persisted over the past two months. The debt ceiling issue was largely resolved and the impact of bank disruptions alleviated, marking a substantial possibility that the Fed's policy will return to be data-dependent. Manufacturing and service data globally diverged greatly, while the US economic fundamentals remained robust. However, we observed that some economic data structures have worsened, and some non-official forward-looking indicators also showed weakness. Moreover, as falling inflation starts to affect corporate profits, the US economy is expected to weaken gradually, but the timing remains uncertain. At the end of the month, the market corrected its expectations for the number of rate cuts in the coming year, returning to our forecast one more cut. We continue to maintain our prediction of one cut this year. US Treasury yields broke over March highs before falling. Without substantial risk events in the foreseeable future, the rates are expected to trade within a loose bound for some time before heading towards a directional bias. In the longer term, we maintain our bull-steepening call for the yield curve.

For corporate bonds in May, overall credit spreads were flat and traded in tandem with interest rates, indicating the return to normalcy of market sentiment. At the end of May, the high interest rate environment was opportune for building positions in long-duration bonds. Looking ahead, we believe that the natural hedge between the Treasury yields and credit spreads will continue, and therefore, we maintain a cautiously optimistic outlook for corporate bonds under the high coupon environment. Specifically, the US expects a large amount of new bond supply in the next month, and the divergence between large banks and regional banks is expected to continue, with most companies' credit conditions remaining solid. Europe's overall inflation and economic conditions are currently weaker than those of the US, but asset prices have generally led since the beginning of the year, with a cautious market sentiment overall. For China, SOE credit spreads remain low due to technical factors, and we expect this support to continue for the short term. In the real estate sector, policy measures continue to be introduced to ameliorate the sector decline. In emerging markets, the economic fundamentals among countries are divergent, and inflation has slightly declined. Most countries have ended their rate hikes before the Federal Reserve, and some countries' domestic demand and political situation are worth cautioning. In a cycle where interest rate peaks and the economy faces recessionary pressure, long-term bond allocation exhibits good value. In the short and medium term, the current corporate bond yield curve is still significantly inverted due to the shape of interest rates, and it is expected to be difficult to have a one-directional trend. A primary approach in the coming period is to maintain a dumbbell strategy to collect high coupon-yields while trading longer-duration bonds in between interest rate fluctuations. Overall, US Treasury yields are still at recent highs from a technical perspective, paving the way for some potential buying opportunities. Meanwhile, with strong market demand for credits, spreads remain at tight levels, and it is necessary to be cautious against the risk of spread widening.

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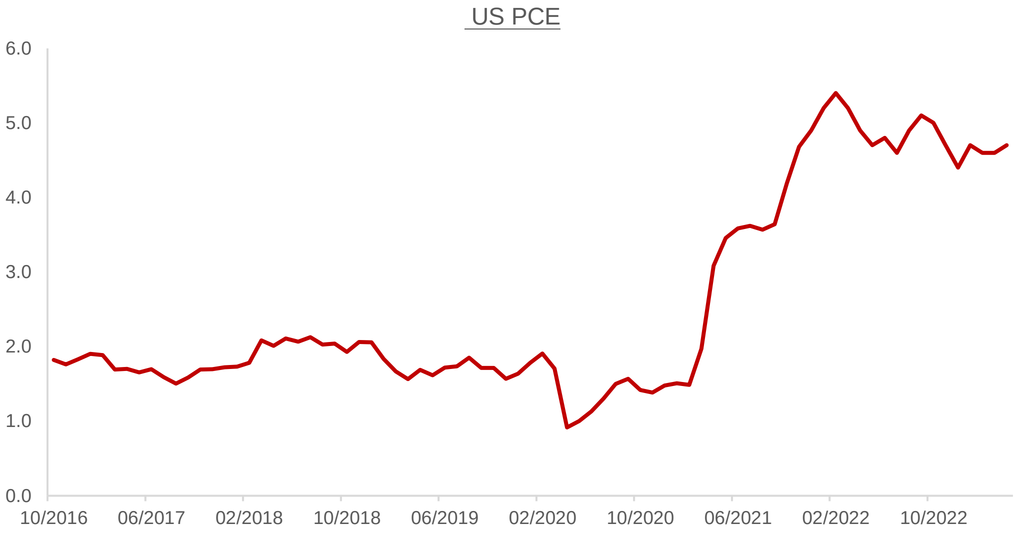

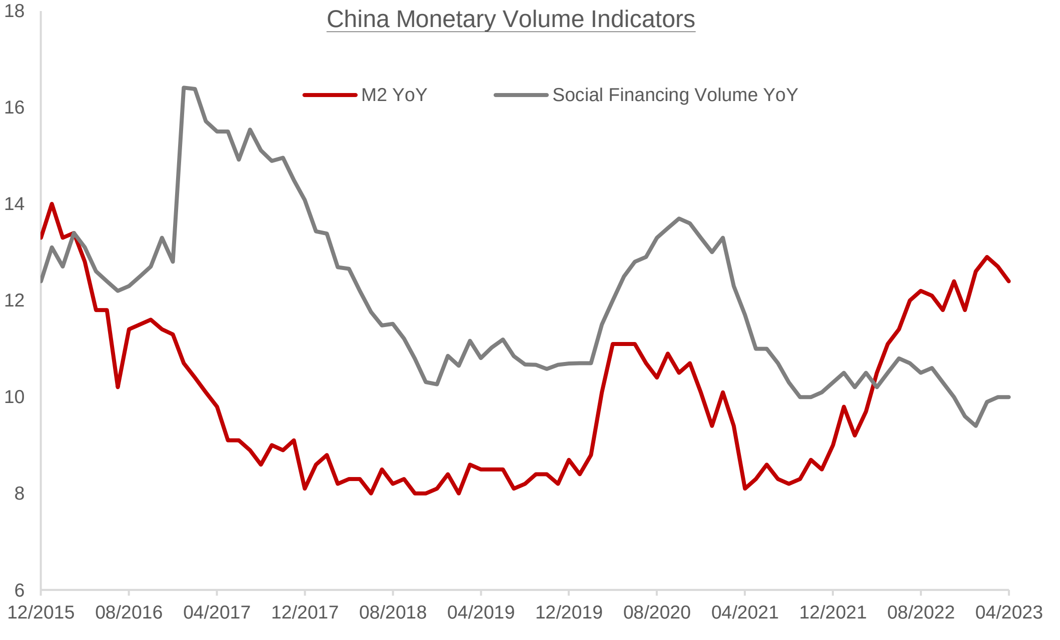

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