ChinaAMC(HK)

MARKET INSIGHTS

Timely shift to fiscal stimulus grows essential

July 2023

Equity

In June, the MSCI China Index rose 3.38%. Weakening economic data led to increased expectations for stimulus policies. From mid-June, investor optimism waned due to the underwhelming implementation of stimulus policies, resurgence of crackdown in tech sector, hawkish global central bank outlooks, and a weakening Chinese yuan. China's Manufacturing PMI remained in contraction, with weak domestic and external demand. Against the backdrop, policymakers are shifting to a more proactive policy stance to stabilize economic growth. Following Blinken, Yellen's visit to China indicates a clear easing trend in China-US relations in the medium and short term. We will be observing whether the State Council meeting in mid-July and the Politburo meeting in late July will introduce more growth-stabilizing measures.

Market Performance

MSCI China index rebounded by 3.38% in the month of June. The market rose from May slippage on hopes of weak data triggering major stimulus and US-China re-engagement. However, optimism faded from mid-Jun on actual stimulus undershooting expectations, renewed US tech restrictions, hawkish guidance from global central banks and weakening CNY. China's export growth dropped to -7.5% YoY in May, much lower than the consensus expectation of -1.8% YoY, with the weakness visible for both DM and EM trading partners. China's May credit data including both new yuan loans and total social financing came in below expectations though household and corporate lending improved. The PBoC surprised the market by cutting the 7-day reverse repo rate by 10bp on Jun 13, fueling hope for more easing measures. Premier Li Qiang chaired the State Council meeting on Jun 16 and hinted that a basket of growth-promoting policies could be released soon. The PBoC held its Q2 MPC meeting on Jun 28 and pledged to intensify countercyclical adjustment to support domestic demand, boost consumption and build a virtuous circle of economic growth.

Greater China Indices	Jun Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	3842.45	1.16	-0.75	3495.95	4479.49
MSCI China	60.57	3.38	-6.05	47.43	75.86
HSI	18916.43	3.74	-4.37	14597.31	22700.85
HSCEI	6424.88	4.24	-4.18	4919.03	7773.61
Global Indices					
S&P 500	4450.38	6.47	15.91	3491.58	4458.48
Dow Jones Industrial Average	34407.60	4.56	3.80	28660.94	34712.28
Nasdaq Composite	13787.92	6.59	31.73	10088.83	13864.06
FTSE 100	7531.53	1.15	1.07	6707.62	8047.06
DAX 30	16147.90	3.09	15.98	11862.84	16427.42
Nikkei 225	33189.04	7.45	27.19	25621.96	33772.89

Economic Data

China's manufacturing PMI improved to 49.0 in Jun from 48.8 in May, remained in contractionary territory due to relatively weak demand both internally and externally. The new order sub-index rose to 48.6 in Jun from 48.3 in May, and the output sub-index rose to 50.3 in Jun from 49.6 in May, back to expansionary territory. The non-manufacturing PMI further fell to 53.2 in Jun from 54.5 in May, maintaining a relatively high level of prosperity since the beginning of the year and suggesting continued recovery in construction and services sectors but at a slower sequential pace. The construction sub-index moderated to 55.7 in Jun from 58.2 in May, on the back of some renewed stress in the property sector. The services sub-index slowed to 52.8 in Jun from 53.8 in May, with the PMIs in airlines transport services and telecommunication above 60 while the PMIs in wholesale and property sector below 50.

Data Source: unless otherwise specified, the data in this report extracted from Bloomberg and Wind, as of 30 June 2023. Data shown is for informational and reference purposes only, historical data does not represent future trend of development.

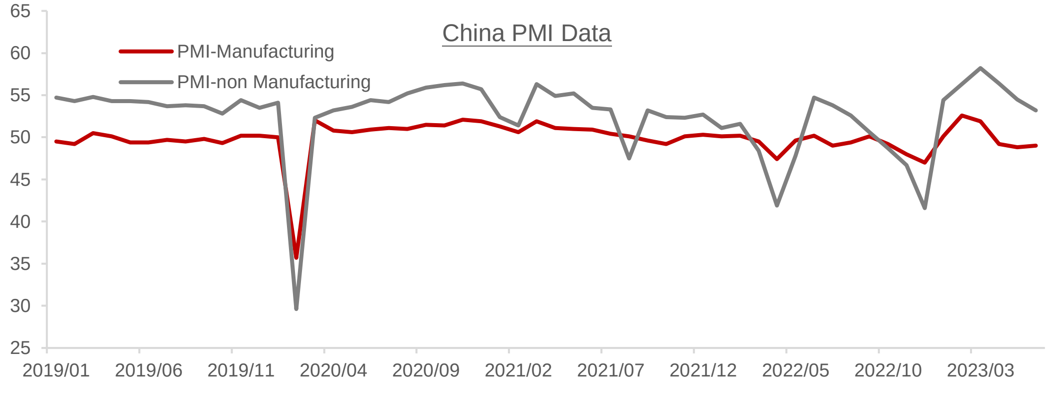
Outlook

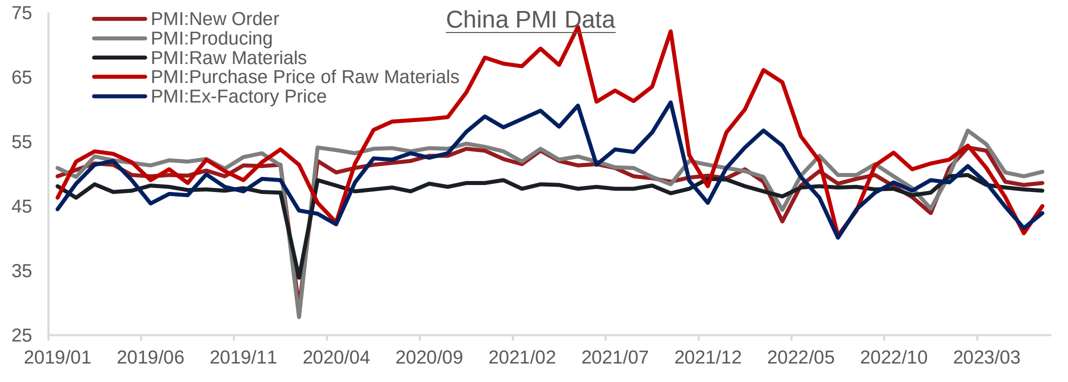
Looking forward, we maintain our long-term positive view on China equity market. On the back of material slowdown of export growth and weak domestic demand, policymakers shifted to a more supportive stance to facilitate overall economic growth, implementing modest rate cuts in June, announcing tax and fee reduction/ deferral for the corporate sector, as well as product-specific stimulus (for NEV, home appliance and furniture), and accelerating the pace of special local government bond issuance. Besides, the US and China are resuming a dialogue on a broadening basis, and that Secretary Yellen's visit, after Secretary of State Blinken's visit, is another step forward towards normalization and stabilization of US/China relations in the near-medium term. We will see whether more pro-growth measures will be rolled out at the State Council meeting in mid-July and the Politburo meeting in late July.

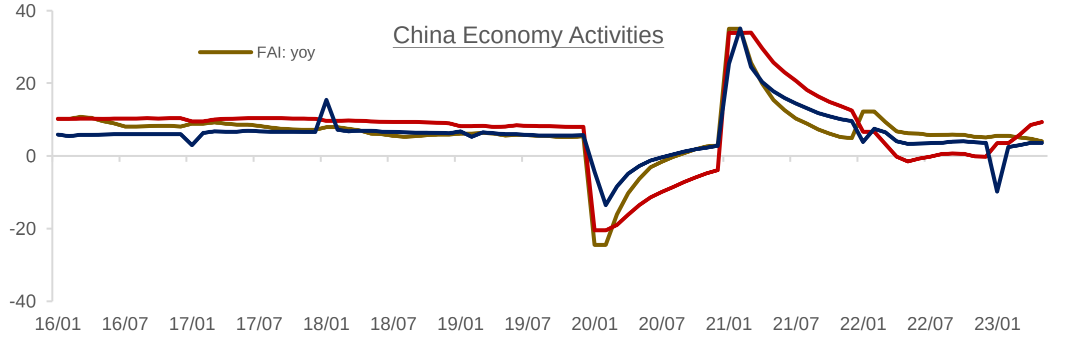
We will continue to seek a balance between value and growth. We continue to focus on the long-term policy beneficiaries (eg. software localization and advanced manufacturing), short-term policy beneficiaries (property and property-related sectors) and reopening-related opportunities (eg. consumer, Internet,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

Risk

Sino-US relationship worsens than expectation. Russia-Ukraine War worsens than expectation; China's economy recovers less than expected.







In June, the "Higher for longer" trading logic returned, with US inflation and economic data exceeding expectations. The June FOMC meeting and Powell's subsequent speech reaffirmed the commitment to combating inflation, emphasizing the possibility of two rate hikes this year. US Treasury yields fluctuated upwards, and developed market equities outperformed. US inflation continued to decline but remained far from the Fed's 2% target. Economic resilience exceeded market expectations. In terms of monetary policy, we believe the Fed's hawkish statements aim to curb rate cut expectations rather than signal continuous rate hikes, thus suppressing inflation. As a result, we adjust the rate cut starting point to around mid-next year, maintaining a steeper initial slope.

Market Performance

In June, markets returned to trading the "higher for longer" theme, with US inflation and economic data exceeding expectations. The dot plot from the June FOMC meeting and subsequent remarks by Powell reiterated the determination to combat inflation and emphasized the possibility of two more rate hikes later this year. As a result, US bond yields fluctuated upwards, and the inversion between 10-year and 2-year yields further deepened, surpassing 100bp. Nonetheless, as the overall rate hike cycle approaches its end, the US economic data remains robust, and overall global risk sentiment was positive. In June, developed market equity outperformed, volatility declined, and corporate bonds performed better than government bonds. Regarding the performance over the past six months, US stocks and Japanese stocks have taken the lead, fixed income assets have also generated decent returns in a high interest rate environment, and commodities have lagged relatively.

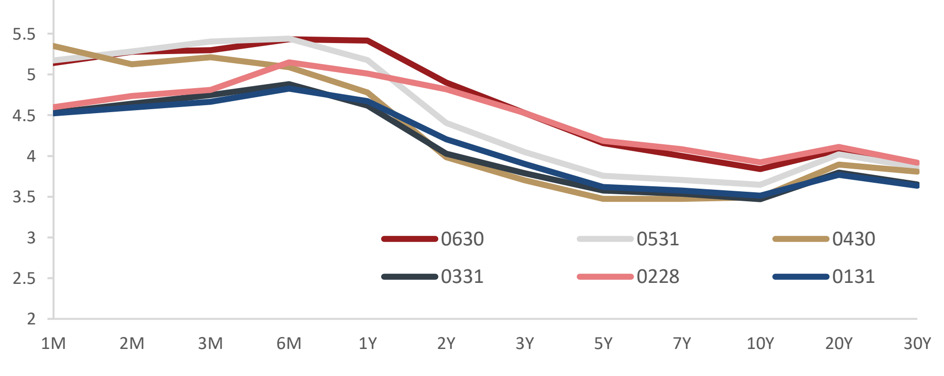
United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	4.40	40	-2	2.65	5.08
5Y	3.75	27	-25	2.58	4.50
7Y	3.70	24	-27	2.56	4.44
10Y	3.64	22	-23	2.51	4.34
30Y	3.86	19	-10	2.85	4.42

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

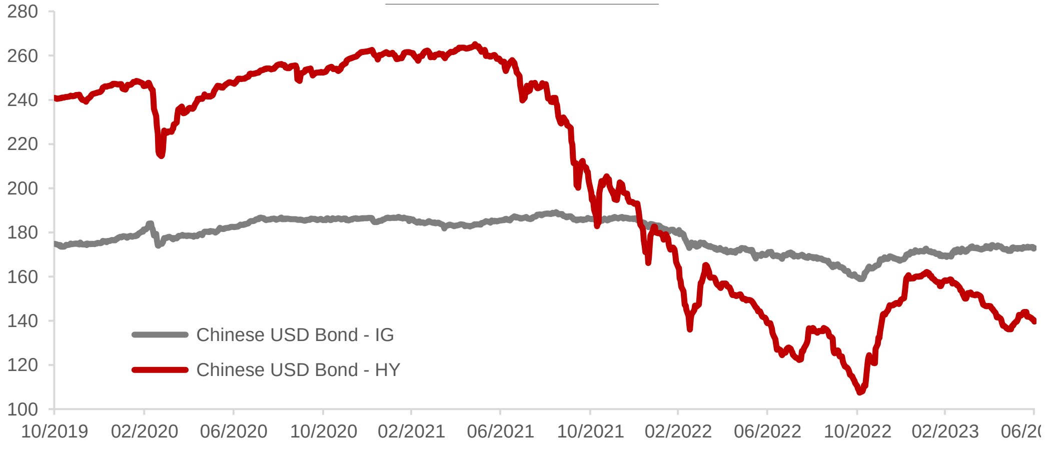


10-year U.S. Treasury yield

In the corporate bond market, global credit spreads have narrowed amid rising interest rates and favorable risk sentiment, returning to levels seen before the March banking crisis. Supply of new bonds in developed markets remains relatively abundant, and funds continue to flow in, leading to further compression of spreads across credit ratings. For Chinese USD bonds, new supply remains low, mainly in the LGFV sector. Technical support for investment-grade bonds is still present, and spreads in some sectors are approaching five-year lows. At the beginning of the month, the high-yield real estate sector rebounded with the support of potential policy support. However, the sector weakened again due to weak sales and policy measures falling short of expectations. In the month as a whole, Chinese investment-grade bonds fell by 0.2%, while Chinese high-yields rose by 2.1%.

CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	66	(9)	(16)	66	114
HY CDX	430	(45)	(54)	400	640
EM CDX	213	(33)	62	205	395
Bond index					
ICE Asian Dollar Corporate	428	0.1%	2.7%	384	432
ICE China Issuers Dollar IG Corporate	202	-0.2%	2.9%	185	204
ICE China Issuers Dollar HY Corporate	169	2.1%	-12.1%	115	218
ICE US Corporate	3085	0.3%	3.2%	2809	3142
ICE US High Yield	1478	1.6%	5.4%	1345	1481
ICE Emerging Markets Corporate	413	0.8%	3.0%	373	417
Bloomberg Global-Aggregate	452	0.0%	1.4%	416	471
Bloomberg Global-Aggregate 1-3 Year	168	-0.1%	0.3%	159	171

Chinese USD Bond Index



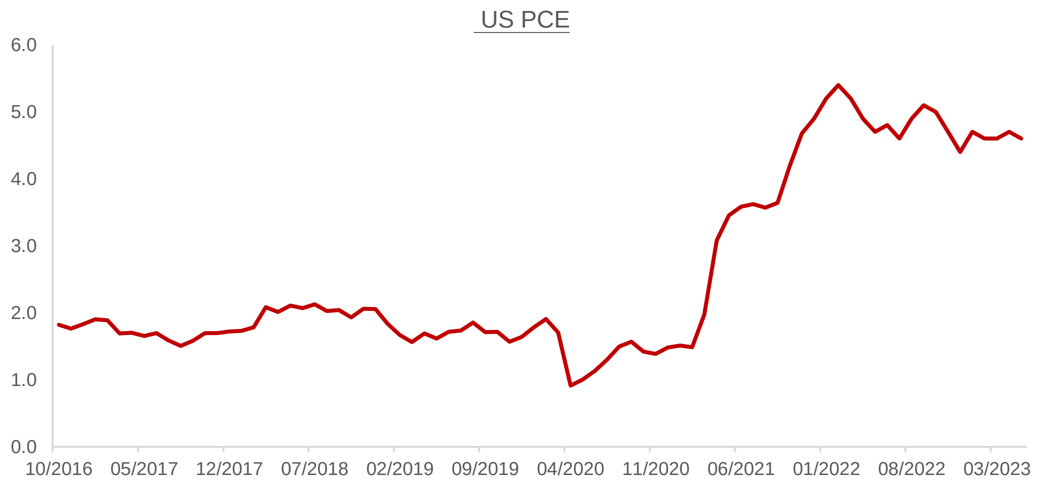
Economic Data

US inflation continues to moderate but remains far from the Fed's 2% target. The economy, however, has shown resilience that surpasses market expectations. First-quarter GDP was revised upward, non-farm payrolls exceeded market estimates, and various housing indicators showed signs of bottoming out and rebounding. Although PMI and durable goods orders slightly fell short of expectations, the probability of a recession in the near term continues to decline. The dot plot from the FOMC meeting moved noticeably higher compared to March, leading the market to expect a higher probability of an interest rate hike in July. Apart from Japan, other G7 central banks generally adopted a hawkish stance, while Europe as a whole continues to show signs of economic weakness.

Outlook

Market sentiment was relatively upbeat in June. Despite continued hawkishness from central banks in Europe and the US, strong US economic data strengthened expectations of a soft landing for the US economy, supporting a significant rebound in risk assets. Currently, the US economy and financial system remain relatively healthy, especially with the continued strength in consumer spending. Since April, key financial indicators has not declined further despite ongoing rate hikes. Housing data, a leading indicator, has shown signs of improvement as low inventory and stabilized mortgage rates have supported a recovery. The likelihood of a recession within the year is reduced unless a black swan event occurs. That being said, the US economy still faces significant downside risks early next year. As monetary tightening transmits to businesses and affects households through multiple channels, both the real economy and overheated financial assets face the risk of a reversal. In terms of monetary policy, the hawkish statements from the Fed are aimed at curbing expectations of interest rate cuts rather than signalling a continued series of rate hikes. Therefore, we adjust the starting point for rate cuts to around mid-next year, while maintaining the expectation of steeper initial rate cuts. Regarding US Treasuries, the yields may attempt to approach previous highs before the July FOMC meeting, but in the medium term, the shape of the yield curve could show some normalization after the rate hikes are certain to be over. In Europe, due to greater economic pressure, the endpoint for rate hikes may be lower than market expectations. In China, the economic recovery is mixed, awaiting a package of policies to stimulate the economy, although the probability of strong stimulus is low.

For corporate bonds, there has been a clear negative correlation between credit spreads and benchmark interest rates since the beginning of the year, resulting in higher risk-adjusted returns for higher-rated IG credits compared to government bonds. Credit spreads in most sectors have fully recovered from the widening seen since March and are currently at relatively high valuation levels since 2022. Chinese USD bonds as a whole remain mixed: investment-grade bonds remain strong, and the relatively optimistic sentiment has led to a catch-up rally in high-beta names, which is expected to continue in the short term. The high-yield property sector is expected to remain under pressure, as various data indicate that sales, especially transaction volumes, are unlikely to recover in the short term. The impact of potential stimulus policies on the overall real estate market and private developers also carries some uncertainty, so a cautious approach is maintained. In terms of strategy, we remain neutral on overall duration, with a relatively optimistic view on interest rate duration and a relatively cautious approach to credit duration. On one hand, global corporate bonds are currently trading at historically high levels since the 2008 financial crisis, and high-grade bonds with medium to long duration have some allocation value with recent rate increases. However, caution should be exercised due to the asymmetry of potential upside and downside in credit spreads. On the other hand, the deeply inverted yield curve has led to historically high ratios between short-term and longer-term bond yields. During periods of wide fluctuations in long-term interest rates, it may be suitable to allocate certain short-duration bonds to capture short-term opportunities, especially in markets with good liquidity. Additionally, we will continue to focus on the value of ESG bonds, which have underperformed in relative terms over the past year, in order to capture long-term investment opportunities.


US PCE
6.0
5.0
4.0
3.0
2.0
1.0
0.0
10/2016
05/2017
12/2017
07/2018
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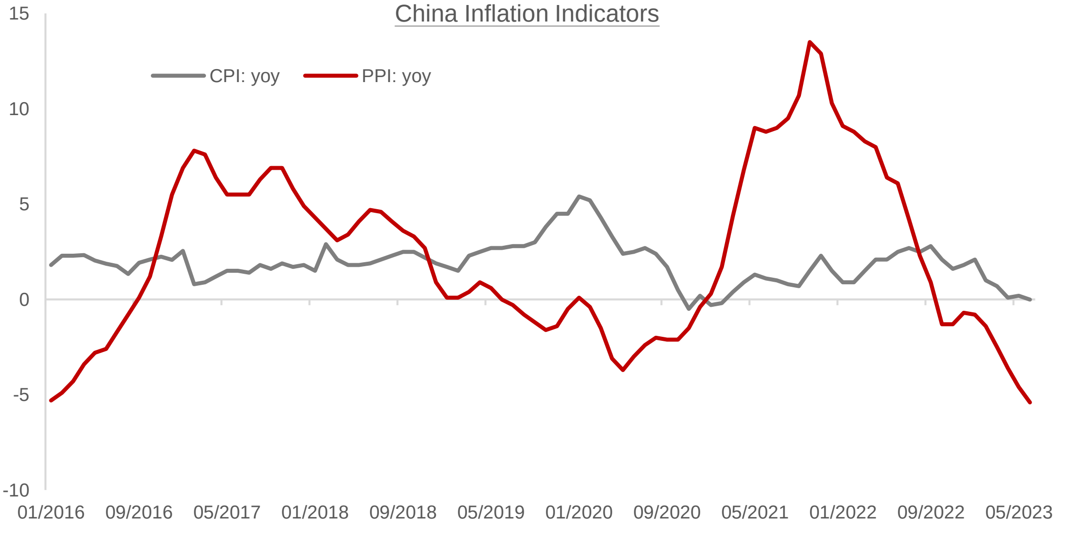
01/2022
08/2022
03/2023


China Inflation Indicators
CPI: yoy
PPI: yoy
15
10
5
0
-5
-10
01/2016
09/2016
05/2017
01/2018
09/2018
05/2019
01/2020
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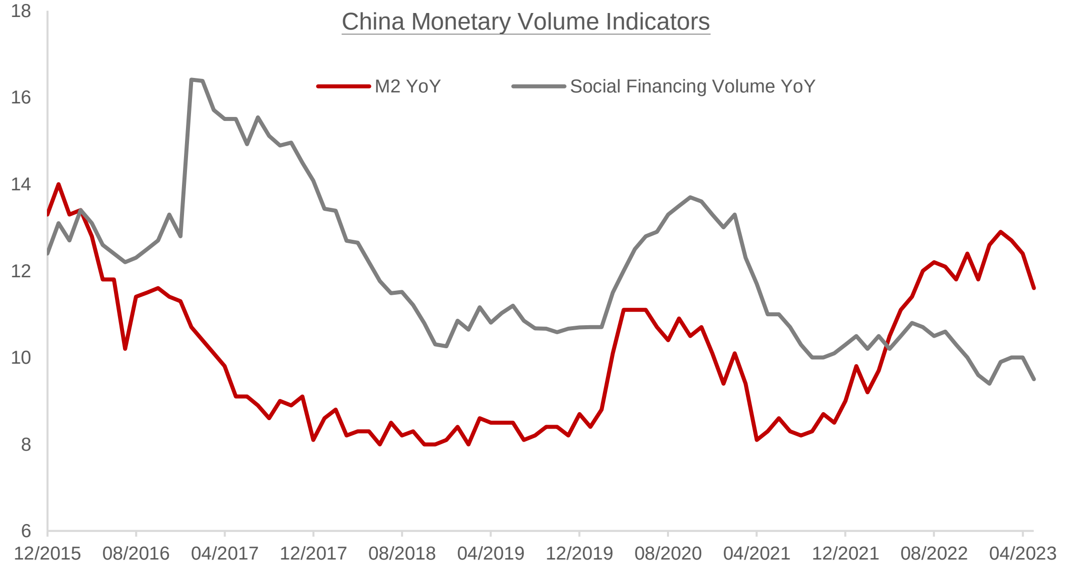
09/2022
05/2023


China Monetary Volume Indicators
M2 YoY
Social Financing Volume YoY
18
16
14
12
10
8
6
12/2015
08/2016
04/2017
12/2017
08/2018
04/2019
12/2019
08/2020
04/2021
12/2021
08/2022
04/2023

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China Asset Management (Hong Kong) Limited

Phone: (852) 3406 8688

Fax: (852) 3406 8500

Product inquiry and client service

Email: hkservice@chinaamc.com

Phone: (852) 3406 8686

Follow us: ChinaAMC (HK)