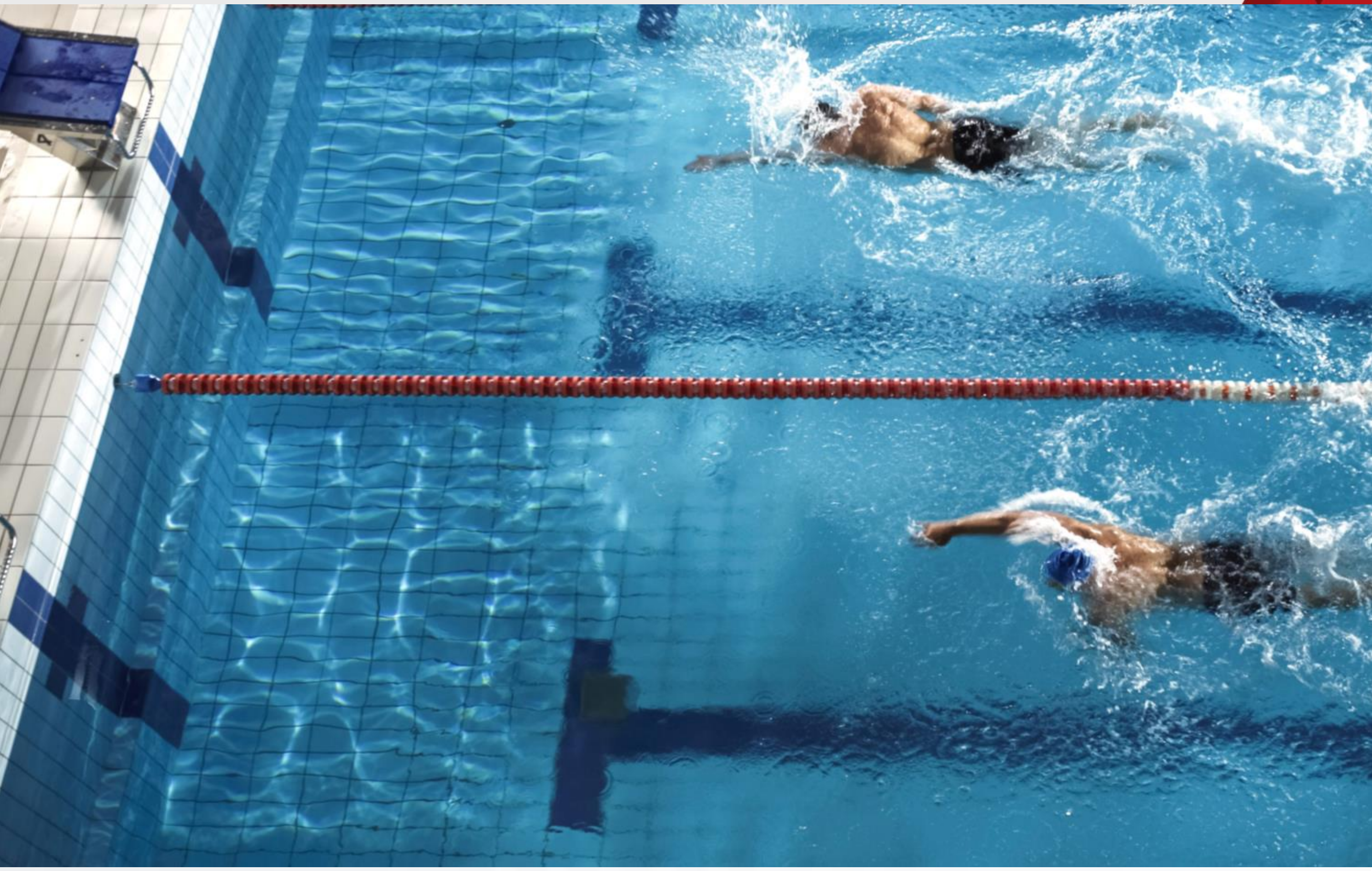


MARKET INSIGHTS

Fed rate hikes likely nearing an end

August 2023

Equity

MSCI China index rose by 9.30% in the month of July, driven by a series of favorable policy moves following the Politburo meeting and more favorable external environment. Chinese top leadership essentially gave the green light for more forceful easing measures to stabilize the real estate market. The manufacturing activity has shown initial signs of stabilization after a period of rapid destocking. Meanwhile, the successive and incremental easing should rein in further downside to growth and foster a re-acceleration of economic activities later. Recent policy developments may offer more support to the market and we tend to be more positive on the short-term performance of China equity market, though further policy efforts on fundamentals are still needed to fully turn things around. We expect to see more property policy easing, faster infrastructure spending, and more pro-tech regulations in the coming months.

Market Performance

MSCI China index rose by 9.30% in the month of July, driven by a series of favorable policy moves following the Politburo meeting and more favorable external environment. The Politburo meeting in July emphasized the reinforcement of counter-cyclical adjustments and policy support. Although the language on consumption boosting and "unwavering support" for private economy were largely reiterations of previous policy announcements, the discussions on property market and local government implicit debt marked a major shift. By dropping "housing is for living in, not for speculation" and explicitly acknowledging the fundamental changes in housing demand and supply balance, the top leadership essentially gave the green light for more forceful easing measures to stabilize the real estate market. Similarly, the statement "to formulate and implement a basket of debt resolution plans" suggested lower left tail risk associated with LGFVs. The external environment has also marginally improved as the Fed raised interest rates by 25bp in July as expected, possibly marking the end of the rate hike cycle.

Greater China Indices	Jul Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	4014.63	4.48	3.69	3495.95	4268.15
MSCI China	66.20	9.30	2.68	47.43	75.86
HSI	20078.94	6.15	1.50	14597.31	22700.85
HSCEI	6899.31	7.38	2.90	4919.03	7773.61
Global Indices					
S&P 500	4588.96	3.11	19.52	3491.58	4607.07
Dow Jones Industrial Average	35559.53	3.35	7.28	28660.94	35679.13
Nasdaq Composite	14346.02	4.05	37.07	10088.83	14446.55
FTSE 100	7699.41	2.23	3.32	6707.62	8047.06
DAX 30	16446.83	1.85	18.12	11862.84	16528.97
Nikkei 225	33172.22	-0.05	27.12	25621.96	33772.89

Economic Data

China’s manufacturing PMI rose slightly to 49.3 in Jul from 49.0 in Jun, remained in contractionary territory. The new order sub-index rose to 49.5 in Jul from 48.6 in Jun, while the output sub-index edged down to 50.2 in Jul from 50.3 in Jun. The non-manufacturing PMI further fell to 51.5 in Jul from 53.2 in Jun, suggesting both the construction and services sectors continued to recover sequentially, but at a slower sequential pace. The construction sub-index fell notably to 51,2 in Jul from 55.7 in Jun, dragged by adverse weather such as high temperature and heavy rainfall. The services sub-index slowed to 51.5 in Jul from 52.8 in Jun, with the PMIs in airlines transport, postal, IT and telecommunication above 60 while the PMIs in capital market and property sectors below 50.

Data Source: unless otherwise specified, the data in this report extracted from Bloomberg and Wind, as of 31 July 2023. Data shown is for informational and reference purposes only, historical data does not represent future trend of development.

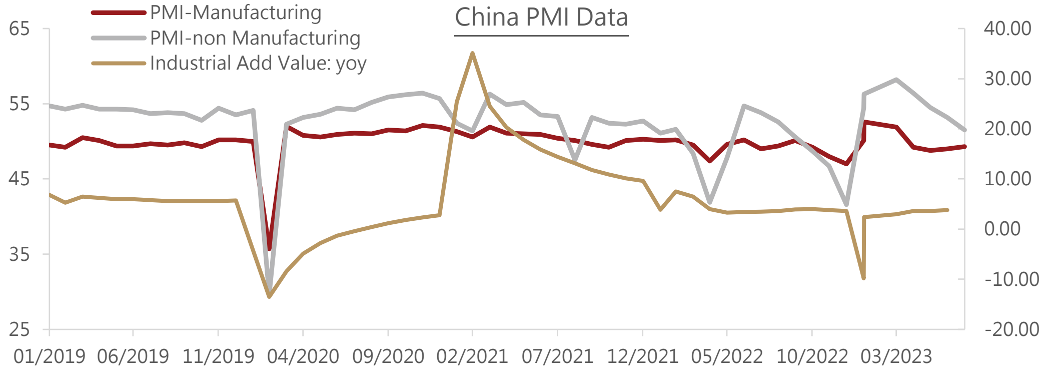
Outlook

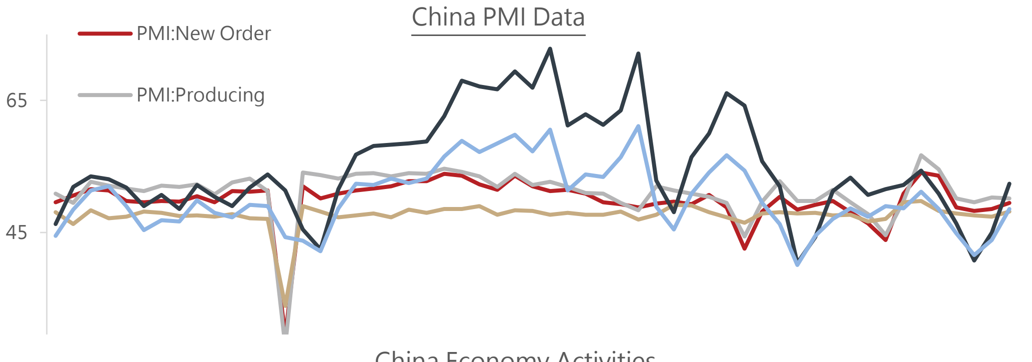
Looking forward, we maintain our long-term positive view on China equity market. The manufacturing activity has shown initial signs of stabilization after a period of rapid destocking. Meanwhile, the successive and incremental easing should rein in further downside to growth and foster a re-acceleration of economic activities later. Recent policy developments may offer more support to the market and we tend to be more positive on the short-term performance of China equity market, though further policy efforts on fundamentals are still needed to fully turn things around. We expect to see more property policy easing, faster infrastructure spending, and more pro-tech regulations in the coming months.

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 and financials). 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.





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In line with market expectations, the FOMC raised interest rates by 25 basis points, and the market interpretation is dovish. The market sentiment was relatively optimistic, with most companies exceeding profit expectations during the earnings season. In terms of major asset classes, commodities outperformed stocks and bonds. The July economic data and the central bank's statements have increased discussions about a soft landing in the market. However, inflation, especially in sticky categories, remains significantly higher than the Fed's target, and there are still divergences in employment data. We continue to see US policy rates remain high for a longer period of time, and the US might not be able to completely avoid a recession next year, so we need to be cautious of excessive market optimism.

Market Performance

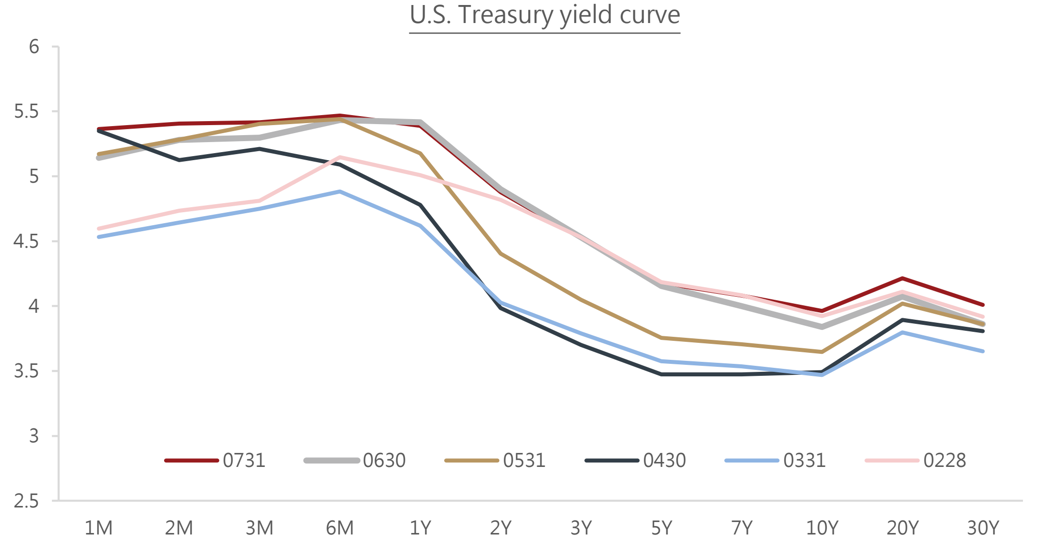
In July, markets saw a shift in trading logic as signs of a turnaround in key data such as inflation and employment emerged. In line with market expectations, the FOMC raised interest rates by 25 basis points, but overall gave out no significant additional information, and the market interpretation is dovish. Investors had differing opinions on whether this would be the last rate hike in this cycle. US bond yields fluctuated widely, with the 10-year yield briefly surpassing 4% in an overall steepening move for the curve. The market sentiment was relatively optimistic, with most companies exceeding profit expectations during the earnings season. In terms of major asset classes, commodities outperformed stocks and bonds.

United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	4.88	-2	45	3.07	5.12
5Y	4.18	2	17	2.79	4.50
7Y	4.08	8	11	2.73	4.44
10Y	3.96	12	8	2.67	4.34
30Y	4.01	15	5	2.94	4.42

China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.24	1	-17	2.14	2.57
5Y	2.46	5	-17	2.36	2.77
7Y	2.64	2	-18	2.57	2.91
10Y	2.66	2	-18	2.60	2.96
30Y	3.01	0	-19	2.96	3.32

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	0.01	7	-3	-0.11	0.07
5Y	0.18	12	-5	-0.04	0.34
7Y	0.40	21	-5	0.03	0.58
10Y	0.61	21	19	0.16	0.66
30Y	1.52	28	-10	1.05	1.72

Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	3.04	-16	27	0.41	3.38
5Y	2.54	-1	-4	0.61	2.90
7Y	2.48	1	-9	0.63	2.82
10Y	2.49	10	-8	0.83	2.77
30Y	2.57	18	2	1.08	2.72



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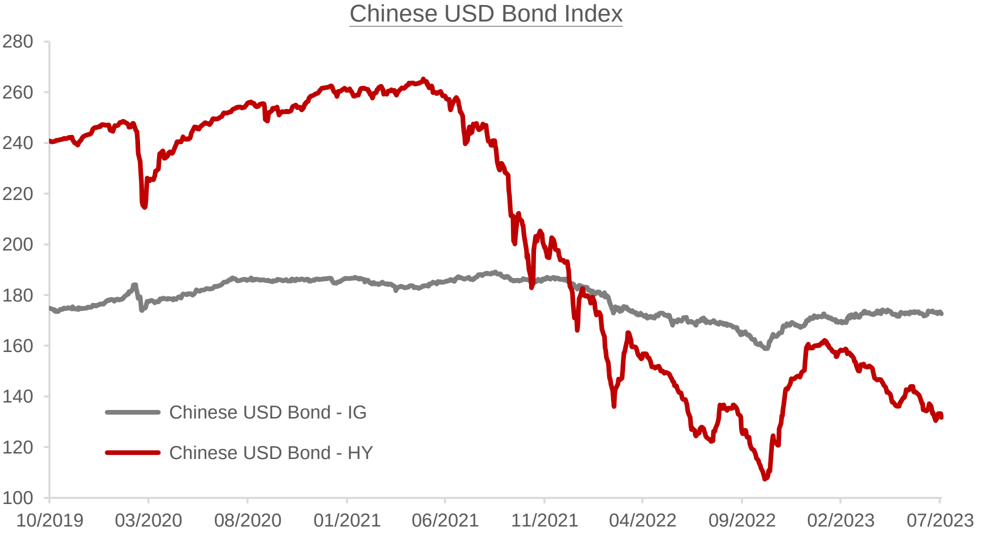
10-year U.S. Treasury yield

In the corporate bond market, technical support as the rate hike approaches its end helped further narrow credit spreads, with some sectors reaching their lowest spreads since the beginning of the year. This resulted in corporate bonds outperforming government bonds for the month, and most large US banks exceeded second-quarter earnings expectations. In the Chinese market, stimulus policies led to some tightening in investment-grade bond spreads, while the high-yield real estate sector experienced a significant decline due to further sales downturns and negative headlines. Over the month, Chinese investment-grade bonds rose by 0.4%, while high-yield bonds fell by 6.1%.

主要CDX 指数	现值	一月变动	YTD变动	52周低点	52周高点
投资级 CDX	63	(3)	(19)	62	114
高收益 CDX	409	(21)	(75)	400	640
新兴市场 CDX	191	(22)	39	188	346
主要债券指数					
亚洲美元公司债	429	0.2%	2.9%	384	432
中资美元债 投资级	203	0.4%	3.2%	185	204
中资美元债 高收益	159	-6.1%	-17.5%	115	218
美国投资级	3098	0.4%	3.7%	2809	3133
美国高收益	1499	1.4%	6.9%	1345	1499
新兴市场公司债	416	0.8%	3.8%	373	417
全球投资级债券指数	455	0.7%	2.1%	416	469
全球1-3年投资级债券指数	170	1.2%	1.5%	159	171

Chinese USD Bond Index



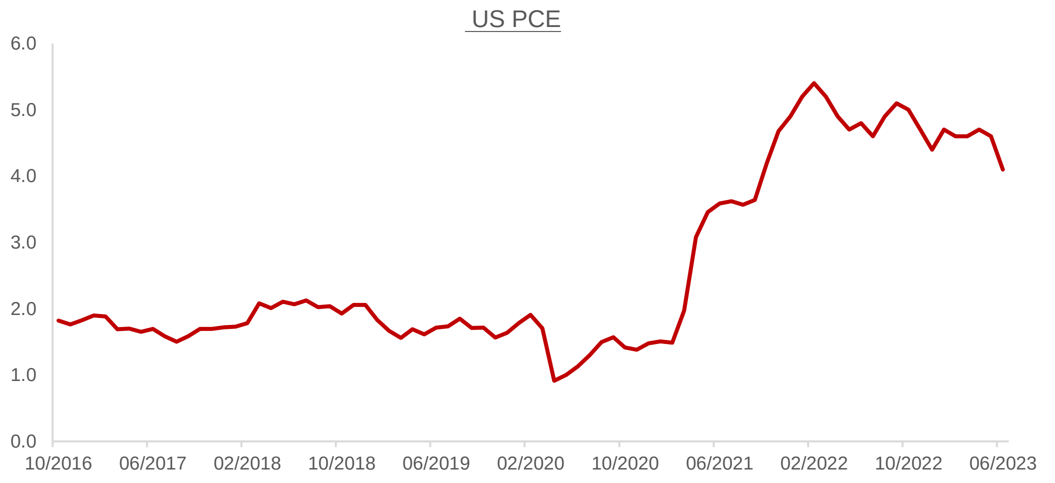
Economic Data

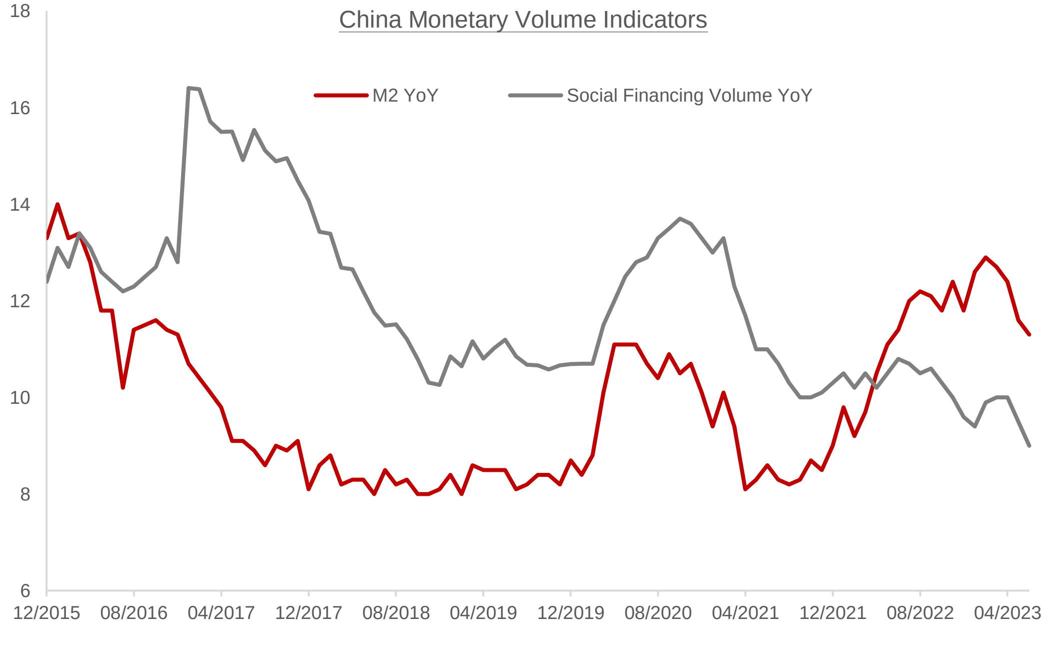
Key economic data in the US exceeded expectations, with both CPI and PCE inflation lower than expected and signs of cool-down for sticky price items. Employment data showed signs of a slowdown, with previous values revised downward. Second-quarter GDP grew at an annualized rate of 2.4%, surpassing market expectations, driven by strong investment. Other data showed some divergence, with PMI and retail data falling short of expectations, but housing data continued to show signs of bottoming out. The European Central Bank signaled a dovish stance due to weakening economic conditions and easing inflation, while the Bank of Japan unexpectedly adjusted its yield curve control policy to address inflation.

Outlook

The July economic data and the central bank's statements have increased discussions about a soft landing in the market. However, inflation, especially in sticky categories, remains significantly higher than the Fed's target, and there are still divergences in employment data. The next consumer data will be crucial in determining whether the US can avoid a recession in this cycle. The Fed is expected to maintain its data-dependent stance, and the economic data for the summer months will provide guidance for the Fed's next policy move. We continue to see US policy rates remain high for a longer period of time, and the US might not be able to completely avoid a recession next year, so we need to be cautious of excessive market optimism. In the US Treasury market, increased supply may be a major factor restraining the fall in bond yields in the second half of the year. After reaching a peak in curve inversion early July, the situation gradually improved, and we believe this trend will continue, but at a slower pace. The economic situation in Europe, weaker than expected, may lead to an earlier shift in central bank policy. In emerging markets, the window for interest rate cuts has already opened, and most Latin American countries may enter a rate-cutting path in the future. The political meeting of the Chinese Politburo released some positive signals, but the probability of large-scale stimulus remains limited.

For corporate bonds, strong demand for fixed income assets has led to continuous tightening of credit spreads, and the relative valuation of US credits compared to assets such as MBS has returned to relatively expensive levels. The credit fundamentals of US issuers also show signs of weakening, and it is expected that credit spreads will continue to fluctuate and widen by the end of the year, with credit curves (especially for higher-rated issuers) steepening. Against this backdrop, we are relatively optimistic about defensive sectors in the US non-financial non-cyclical space. In Europe, we are relatively optimistic about the banking sector, and in the Chinese market, SOEs are expected to receive good support, but we maintain a relatively cautious stance towards real estate LGFVs. In terms of absolute returns, the breakthrough over 4% for the 10-year yield in this rate hiking cycle has often been a good opportunity to build positions in higher-rated bonds. However, as the rate hike approaches its end, it is difficult to reap the benefits of both declining interest rates and spread compression as we did last year. Therefore, we still maintain a focus on higher-rating credits, keeping flexibility and diversification for portfolio allocations.





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