MARKET INSIGHTS

Policy aid spurred a modest turnaround

September 2023

Equity

In August, the MSCI China Index fell by 8.50%. The market lacked specific details on expected easing measures after the political committee meeting, and weak economic data added to the pressure. Factors such as underperforming macro data, depreciation of the renminbi against the US dollar, and widening China-US interest rate differentials affected the Chinese stock market. The sluggish real estate market and its potential impact on the economy were also reasons for the market adjustment. However, positive signs emerged in the last two weeks of August. We maintain a positive long-term outlook for the Chinese stock market as the Chinese government has introduced a series of stimulus measures, including property policy relaxation and interest rate cuts. Economic data and accommodative policies are improving, and this positive trend is expected to continue in the coming months.

Market Performance

MSCI China index dropped by 8.50% in the month of August, due to lack of details of the widely-speculated easing measures and weak economic data. The month of August started with a decent degree of optimism in the air, brought by the communique from the Politburo meeting at the end of July with the mentioning of 'significant shift in the supply demand dynamic of the property sector' and 'reinvigorating capital markets'. However, the weaker-than-expected macro data, the weakening CNY vs. USD and the wider US/CN yield differential put pressure on the performance of China equity market. The ailing housing market and its potential contagion to the real and financial economies are also the widely-cited reasons for the correction.

More positive signs emerged in the last 2 weeks of August. On Aug 18, CSRC announced a comprehensive package of initiatives to revive the capital markets, focusing on improving shareholder returns. On Aug 25, the MOHURD, the PBoC and the NFRA jointly issued a circular to officially allow local governments to scrap the rule of “no mortgage record” for determining the status of “first-home buyers”. On Aug 27, policymakers made a number of changes to support the stock market, including cutting the stamp duty for stock trading by half. It appears that various ministries are following up on the July Politburo meeting's shift in tone in property policies and its call to revive the capital market. On Aug 31, PBoC and NAFR jointly announced more guidelines on existing mortgage rate cut and revised nationwide floor for down payments and mortgage rates.

Greater China Indices	Aug Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	3765.27	-6.21	-2.75	3495.95	4268.15
MSCI China	60.57	-8.50	-6.05	47.43	75.86
HSI	18382.06	-8.45	-7.07	14597.31	22700.85
HSCEI	6332.42	-8.22	-5.56	4919.03	7773.61
Global Indices					
S&P 500	4507.66	-1.77	17.40	3491.58	4607.07
Dow Jones Industrial Average	34721.91	-2.36	4.75	28660.94	35679.13
Nasdaq Composite	14034.97	-2.17	34.09	10088.83	14446.55
FTSE 100	7439.13	-3.38	-0.17	6707.62	8047.06
DAX 30	15947.08	-3.04	14.53	11862.84	16528.97
Nikkei 225	32619.34	-1.67	25.00	25621.96	33772.89

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

Equity

Economic Data

China's manufacturing PMI rose to 49.7 in Aug from 49.3 in Jul, remained in contractionary territory. The new order sub-index rose to 50.2 in Aug from 49.5 in Jul, and the output sub-index rose to 51.9 in Aug from 50.2 in Jul. The NBS commented that the output and new orders sub-indexes in some key sectors such as agricultural and sideline food processing, chemical raw materials and products and auto were above 53 in August. The non-manufacturing PMI further fell to 51.0 in Aug from 51.5 in Jul, suggesting both the construction and services sectors continued to recover sequentially, but at a slower sequential pace. The construction sub-index rebounded to 53.8 in Aug from 51,2 in Jul, mainly due to smaller drag from adverse weather in August. The services sub-index slowed to 50.5 in Aug from 51.5 in Jul, as property-related sectors deteriorated further in August.

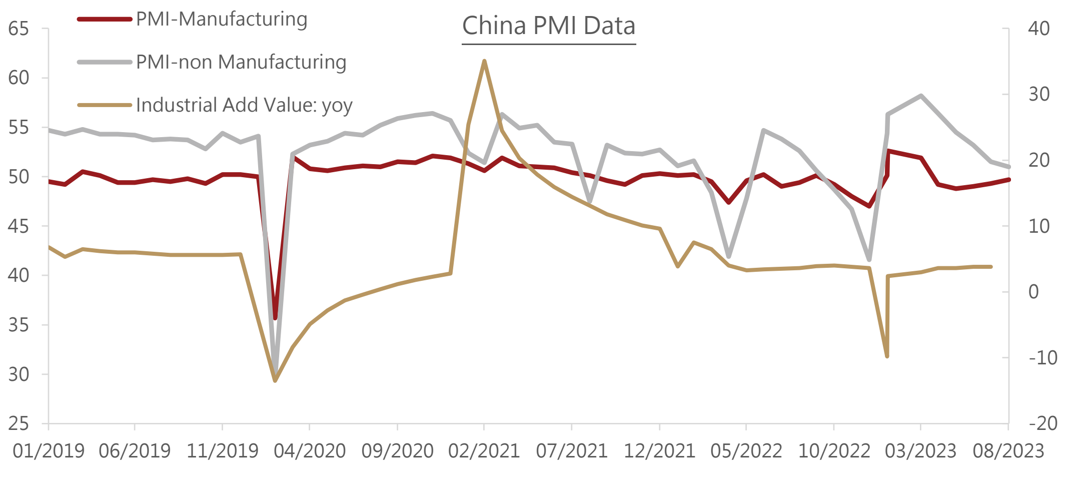
Outlook

Looking forward, we maintain our long-term positive view on China equity market. Chinese government introduced a slew of stimulus measures in the past weeks that covered areas from housing downpayments to stock stamp duty and interest rate cuts, a pace not seen since late 2018. Both economic data and policy easing started to surprise on the upside and the positive trend is expected to continue in the coming months. We expect further property demand-side easing in higher-tier cities, stronger fiscal expansion and further monetary easing, such as RRR cuts and expansion of relending tools. The combination of these measures could allow the economy to rebound modestly from 4Q23 onward.

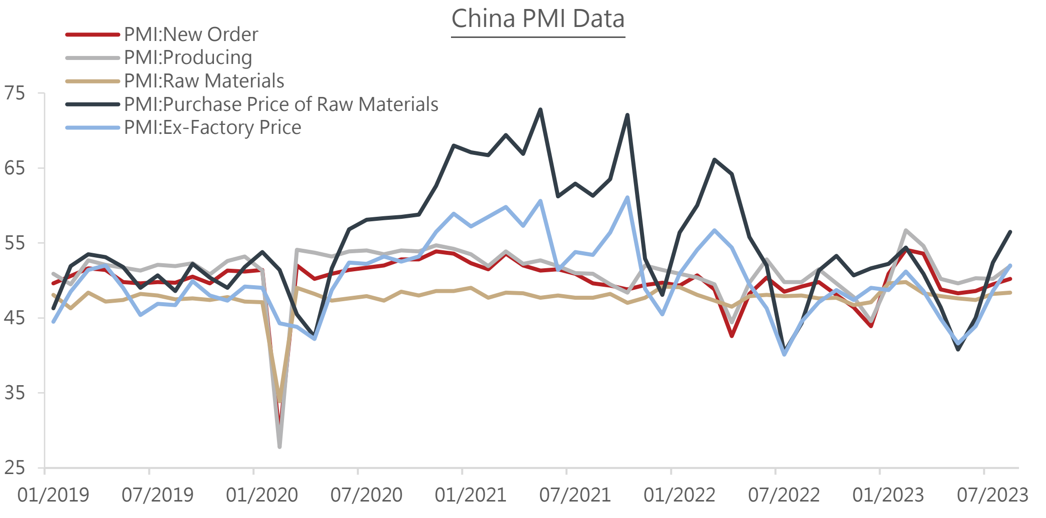
We will continue to seek a balance between value and growth. We continue to focus on the long-term policy beneficiaries (eg. software localization and advanced manufacturing), short-term policy beneficiaries (property and property-related sectors) and reopening-related opportunities (eg. consumer, Internet 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.



Equity


China PMI Data
PMI:New Order
PMI:Producing
PMI:Raw Materials
PMI:Purchase Price of Raw Materials
PMI:Ex-Factory Price
75
65
55
45
35
25
01/2019
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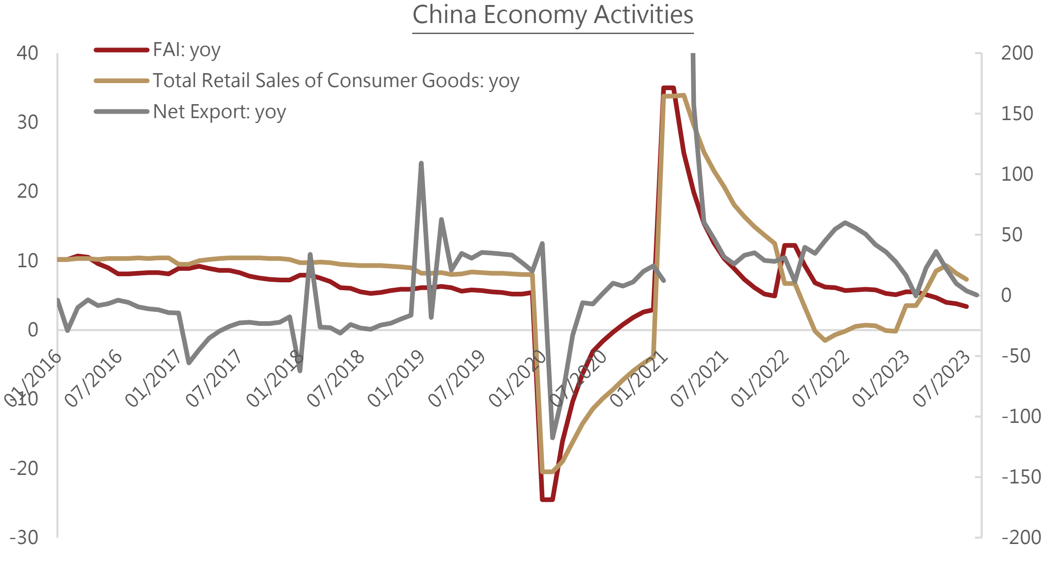
China Economy Activities
FAI: yoy
Total Retail Sales of Consumer Goods: yoy
Net Export: yoy
40
30
20
10
0
-10
-20
-30
200
150
100
50
0
-50
-100
-150
-200
01/2016
07/2016
01/2017
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In August, the market continued its volatility. The first half of the month saw a sell-off in US bonds, resulting in a steep yield curve. With the US economy outperforming China and Europe, the US dollar strengthened, while overall risk sentiment was somewhat tempered due to delayed rate cut expectations. Across major asset classes, most experienced declines, with bonds outperforming stocks and crude oil performing well due to demand factors. In the credit market, US government debt credit ratings were downgraded, and the supply of US bonds exceeded expectations, pushing overall credit bond yields higher. In the Chinese market, sentiment weakened, widening the spreads for investment-grade Chinese bonds. We maintain our view that US policy rates will remain elevated for a longer period. In the short term, current monetary policy by the Federal Reserve aligns well with economic trends, and positive risk sentiment is likely to continue.

Market Performance

Markets continued to fluctuate in August. In the first half of the month, US Treasuries continued to be sold off in a steepening move. Mid-month, long-term Treasury yields reached their highest level since 2008. During the Jackson Hole meeting in the latter half of the month, Powell reiterated the inflation target of 2% and stated that policy rates would be raised as needed to achieve this target. However, there were no adjustments made to the long-term neutral rate framework. Treasury yields fell, and market expectations for a rate hike in September decreased while the probability of a rate hike by the end of the year increased. Against the backdrop of the US economy performing better than China and Europe, the US dollar strengthened, while overall risk sentiment was restrained due to delayed expectations of interest rate cuts. In terms of asset classes, most experienced declines, with bonds outperforming stocks. Crude oil performed well due to support from the demand side.

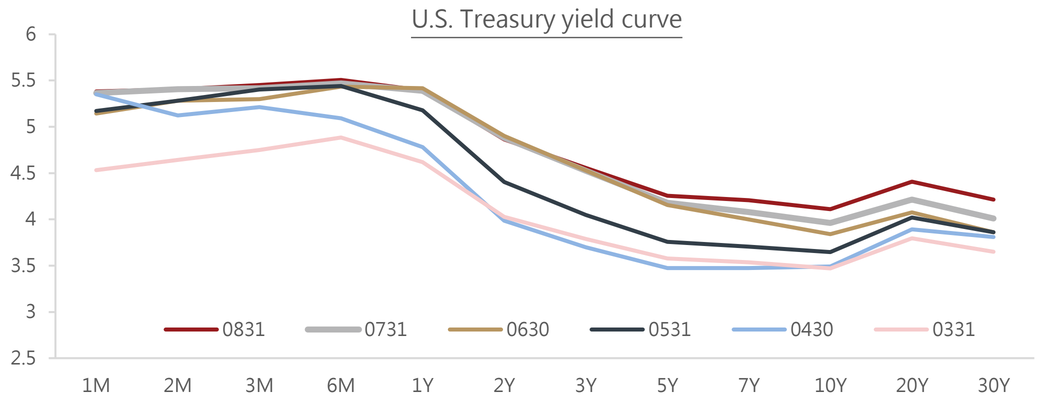
United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	4.86	-1	44	3.39	5.12
5Y	4.25	8	25	3.20	4.50
7Y	4.21	13	24	3.24	4.46
10Y	4.11	15	23	3.19	4.36
30Y	4.21	20	25	3.34	4.47

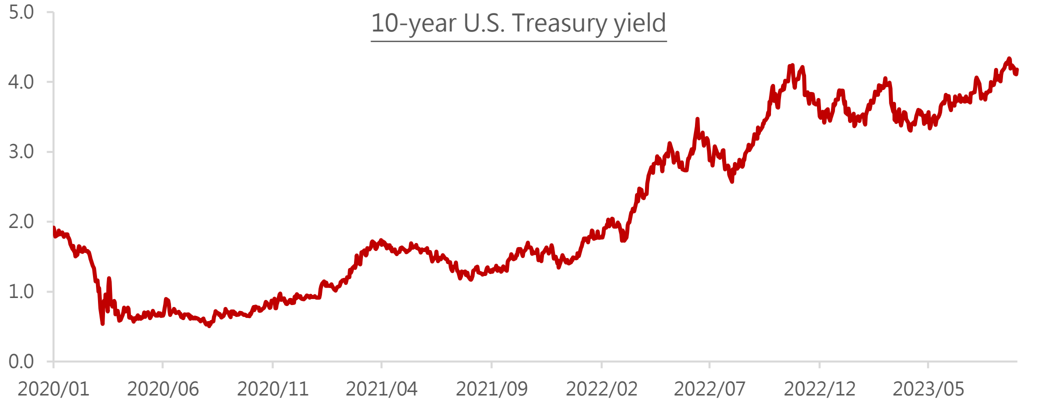
China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.22	-2	-20	2.14	2.57
5Y	2.40	-6	-23	2.34	2.77
7Y	2.57	-8	-25	2.51	2.91
10Y	2.58	-8	-26	2.54	2.96
30Y	2.90	-11	-30	2.88	3.32

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	0.03	3	-1	-0.09	0.07
5Y	0.23	5	-1	0.02	0.34
7Y	0.41	1	-5	0.08	0.58
10Y	0.65	4	23	0.18	0.68
30Y	1.68	16	6	1.11	1.72

Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	2.98	-6	21	0.96	3.38
5Y	2.48	-6	-10	1.24	2.90
7Y	2.45	-3	-12	1.27	2.82
10Y	2.47	-3	-11	1.47	2.77
30Y	2.59	2	5	1.60	2.81

In the corporate bond market, as the credit rating of US government debt was downgraded and Treasury supply exceeded expectations, credit yields climbed accordingly. In the first half of the month, risk sentiment was suppressed due to longer-term expectations, and credit spreads widened slightly in line with US bond yields. In the second half of the month, risk sentiment improved, and market expectations of interest rate hikes decreased, leading to a narrowing of credit spreads, approaching the lows of the year. Among Chinese USD bonds, the spread of Chinese investment-grade bonds widened due to weaker market sentiment, but later tightened due to policy stimulus and fluctuations in spreads. In the high-yield real estate sector, there were corporate defaults in the first half of the month, resulting in continued weak sales and a one-sided decline. Chinese investment-grade bonds fell by 0.8% for the month, while high-yield bonds fell by 7.7%.





CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	64	1	(19)	62	114
HY CDX	425	16	(59)	400	640
EM CDX	202	11	50	188	346
Bond index					
ICE Asian Dollar Corporate	425	-1.0%	1.9%	384	432
ICE China Issuers Dollar IG Corporate	201	-0.8%	2.4%	185	204
ICE China Issuers Dollar HY Corporate	147	-7.7%	-23.8%	115	218
ICE US Corporate	3077	-0.7%	3.0%	2809	3133
ICE US High Yield	1503	0.3%	7.2%	1345	1503
ICE Emerging Markets Corporate	413	-0.9%	2.9%	373	417
Bloomberg Global-Aggregate	449	-1.4%	0.7%	416	467
Bloomberg Global-Aggregate 1-3 Year	168	-0.8%	0.7%	159	171

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Economic Data

Economic data in the United States is mixed. Retail sales and household real income remained strong. The CPI continued to slow down, but the decline in the core component is not as expected. There were signs of cooling in employment data, and housing data has stabilized but lacked a strong rebound. The PMI for the service and manufacturing sectors has declined, indicating that the US economy remained resilient but not as strong as in July. Economic data in Europe shows weak PMI and consumer confidence, as well as a slowdown in inflation. Market expectations for interest rate hikes by the European Central Bank and the Bank of England in September have decreased. Japan's GDP exceeded expectations, but inflation was lower than expected.

In terms of China economic data, industrial production, retail sales, and fixed asset investment were all lower than expected. However, the official manufacturing PMI was 49.7, higher than the expected 49.2. Monetary, financial market, and real estate policies have been continuously implemented to support the economy. In terms of monetary policy, the central bank conducted one-year Medium-term Lending Facility (MLF) operations, lowering the interest rate from 2.65% to 2.50%. The 7-day reverse repo rate was also lowered from 1.90% to 1.80%. The interest rate cut came earlier than the market expected. The one year lending rate decreased by 10bps to 3.45%, while those for five years and above remained unchanged at 4.20%. On the surface, the interest rate cut was lower than market expectations, and the market hoped for more easing policies to support long-term lending. However, on one hand, there is a need to maintain stable bank interest spreads, and on the other hand, the real economy relies on improvements in urban investment and mortgage rates. The central bank lowered the reserve requirement ratio for financial institutions' foreign exchange deposits from the current 6% to 4% to enhance the ability of financial institutions to utilize foreign exchange funds. In terms of real estate policy, the Ministry of Housing and Urban-Rural Development, the People's Bank of China, and the China Banking and Insurance Regulatory Commission have jointly implemented policies such as allowing first-home buyers to enjoy preferential mortgage rates regardless of their previous mortgage records, which have been subsequently implemented in multiple cities including Shenzhen and Guangzhou. They have also adjusted and optimized housing credit metrics, including down payment ratios, real estate interest rates, and rates for existing first-home loans. These measures are mainly aimed at alleviating pressure and stimulating demand.

For USD/CNH spot, the overall trend showed a rise followed by a fall, starting from the level of 7.15, reaching a high of 7.35 in the middle of the month, and then declining to 7.27. This was mainly influenced by funding conditions and policy announcements. For swaps, funding conditions remained tight until the end of the month, with one-day swap points reaching as high as +9, causing volatility in the entire curve, especially in the short end. It is expected that the future curve will be more influenced by the narrowing of the US-China interest rate differential, leading to an upward trend in the long end. In terms of interest rate swaps, a V-shaped trend was observed, with significant volatility in the long end. This was mainly driven by accommodative short-term monetary policies and positive expectations for economic recovery due to policy support. The PBoC issued a total of 35 billion RMB in central bank bills in Hong Kong, with 200 billion for the 3-month tenor, reaching a 3-year high (previous high at 100 billion), and 150 billion for the 1-year tenor.

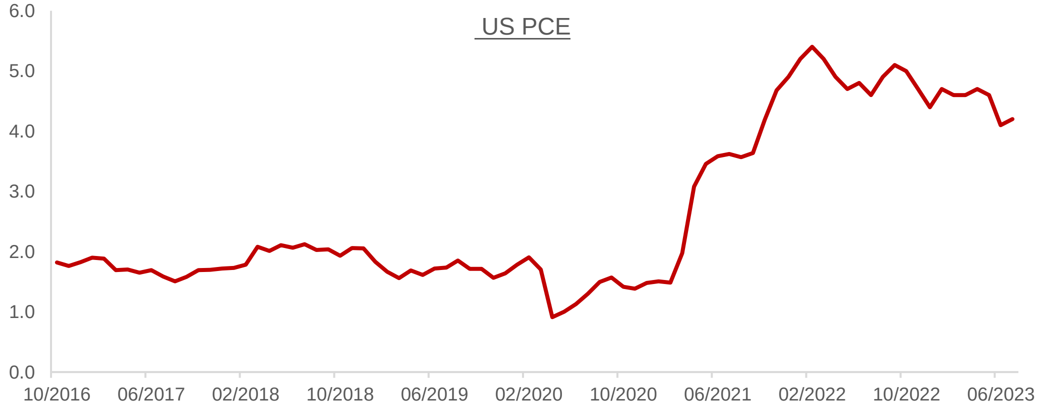
Outlook

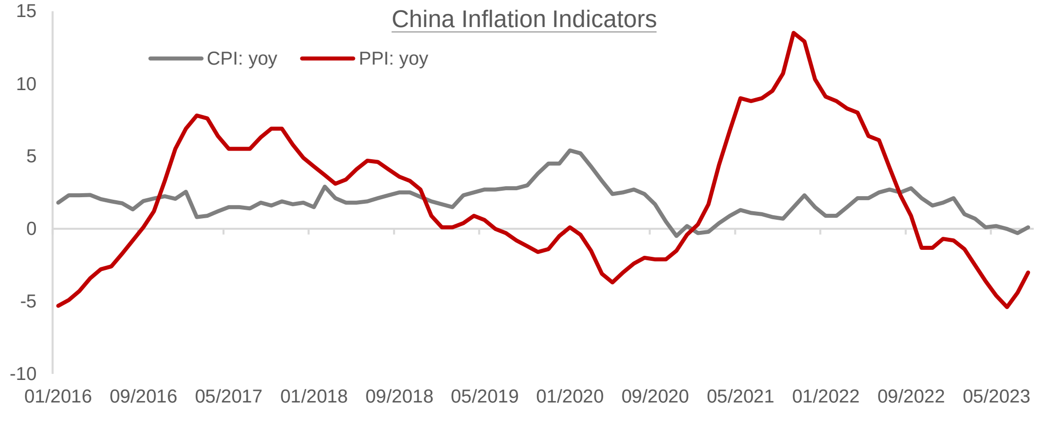
There was divergence across economic data in August, and market expectations for the timing of the next rate hike and the starting point of rate cuts next year have been pushed back. Against the backdrop of adequate liquidity in the financial system, the Fed will continue to monitor the trend of economic data to determine its policies. Although employment data weakened slightly, it indicates a move towards balance rather than a trend of weakening (moving averages of the data are still at high levels). Additionally, the decline in inflation has led to an increase in real household income. If other economic data show resilience, we maintain the view that US policy rates will remain at high levels for a longer period of time. In the short term, the current alignment between Fed monetary policy and economic trends is adequate, and positive risk sentiment is likely to continue. The increase in financing demand announced by the Treasury Department for the third quarter, as well as the maintenance of high interest rates for a longer period of time, may be the main factors suppressing the decline in US Treasury yields in the second half of the year. However, with the improvement in economic data exceeding expectations, the probability of another significant increase in Treasury yields is manageable, and we expect a wide range of fluctuations in the market and the yield curve may steepen further. It is necessary to pay attention to whether consumption, without considering inflation factors, could continue to maintain a good trend, the positive impact of improvements in employment structure on lowering core inflation, and the negative impact of rising oil prices on overall inflation. In the medium term, given high interest rates over a long period of time, negative disruptions and the prospect of a recession next year remain on the table. Therefore, caution should be exercised regarding market over-optimism. In the long term, there is a need to be vigilant about the possibility of neutral interest rates rising. In Europe, the economic slowdown and the shift in central bank stance may bring forward the endpoint for rate hikes. In Japan, attention needs to be paid to political uncertainties and adjustments in monetary policy. In emerging markets, there is a significant divergence in economic and inflation trends. Some Asian countries have been affected by weaker-than-expected data influenced by China, but their internal dynamics remain strong. The overall market expectation for the starting point of rate cuts has been pushed back following Fed's signals.

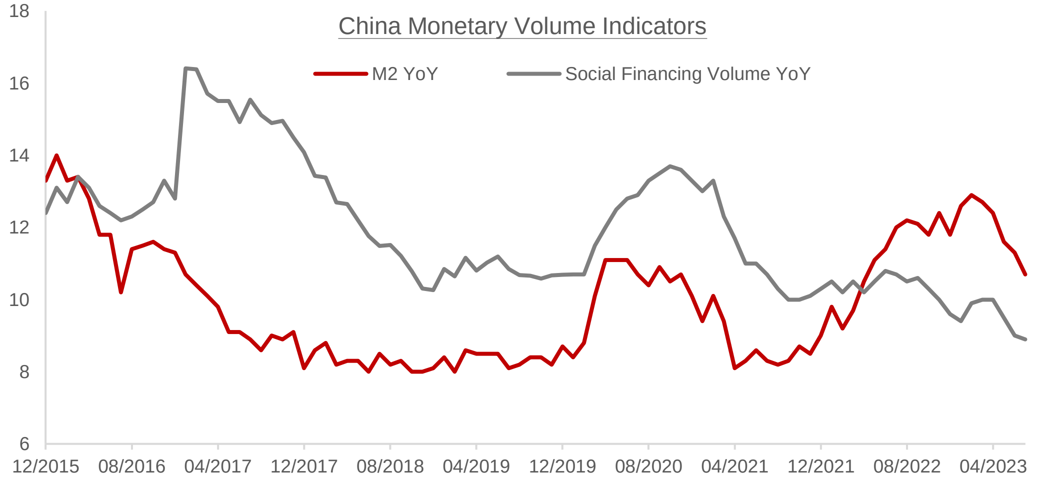
In terms of corporate bonds, the previous narrowing of credit spreads has seen a slight correction this month, as investors' concerns about long-term high interest rates have pushed spreads wider. Ratings of some regional banks were downgraded in the middle of the month (although the long-term tightening of regulatory policies is beneficial for financial stability), resulting in weaker performance of the financial sector compared to sectors such as technology and energy. US companies have released their Q2 reports, with good performance in the technology sector and average performance in the retail sector. The issuance volume of corporate bonds in the first eight months of the year is expected to be larger compared to the same period last year. It is anticipated that credit spreads will continue to fluctuate and widen by the end of the year, and the credit curve, especially for higher-rated issuers, will steepen. Against this backdrop, we are relatively optimistic about defensive sectors in the US that are non-financial and non-cyclical in nature. In Europe, a small number of issuers from banks have issued new capital bonds and redeemed bonds that are due to mature, gaining recognition from investors and further boosting market sentiment in this sector. In the Chinese market, state-owned enterprises (SOEs) are expected to be supported by technical factors, while the performance of the technology, media, and telecommunications (TMT) sector will provide support. Although there are expectations of policy measures being implemented in the real estate sector, the effectiveness still carries significant uncertainty, and bond prices are expected to experience significant volatility. On the other hand, government support in the urban investment sector is more obvious. Some short-term bonds and high-quality issuers with significant premiums in the domestic market could have some allocation value. Overall, we maintain a cautious stance on these two sectors. As the current rate hike cycle approaches its end, credit bonds, especially short-term bonds, have some value from an absolute yield perspective. However, if there is a significant downward movement in long-dated yields, it is advisable to consider taking profits and capturing opportunities from market volatility, while maintaining a focus on higher credit ratings and ensuring portfolios attain sufficient flexibility and diversification.

Looking ahead to next month, USD/CNH spot could fluctuate downward, with a position around 7.3. There is more room for the yuan to depreciate, which will require continued policy efforts, improved economic data, and improved risk sentiment.

Moreover, attention should be given to the stronger seasonal strength of the US dollar in September and the demand for foreign exchange for outbound tourism at the end of the month. As for forward contracts, it is expected that they will trend upward, with the main influencing factor being the funding situation. However, the narrowing of the interest rate differential between China and the US may occur after September, as the Chinese economy needs more time for the data to reflect and there is a large issuance of US government and corporate debt in September. The focus in China will be on whether there will be another reserve requirement ratio cut in the coming months and whether there will be one more interest rate cut before the end of the year. Attention should also be paid to the resistance level of 2.7-2.75 for China's 10-year government bond yield.







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