MARKET INSIGHTS

Home-Buying Rules Eased for Economic Revival

October 2023

Equity

MSCI China index dropped by 3.07% in the month of September. Economic data improved marginally, but it didn't help boost the Chinese stock market significantly. The lower CNY exchange rate and less-than-expected policy effects suppressed market confidence. Several positive policies were announced in September. As macro policies take further effect and coupled with marginal improvements in y-o-y export growth, the y-o-y inventory growth rate may reach its bottom in the fourth quarter. We anticipate that more effective polices will be introduced in the upcoming Politburo meeting in mid-Oct and the Third Plenum this Oct/Nov. We will closely monitor US-China relations to see whether it will continue to stabilize, and the market impact of the rising US bond yields due to the more hawkish stance of the Fed Reserve.

Market Performance

MSCI China index dropped by 3.07% in the month of September. Economic data improved marginally, but it didn't help boost the Chinese stock market significantly. The lower CNY exchange rate and less-than-expected policy effects suppressed market confidence. Several positive policies were announced in September. On Sep 15, the central bank lowered the deposit reserve ratio by 25 basis points to release the liquidity in order to consolidate the effect of previous interest rate cuts. On Sep 20, Guangzhou became the first T1 city to relax home purchase restrictions. On Sep 26, Inner Mongolia planned to issue special government bonds to ease debt pressures. There are also positives in China-US relations. On Sep 22, two countries set up two new working groups on economic, financial issues. On Sep 27, China's Vice-Foreign Minister and US Assistant Secretary of State for East Asian and Pacific Affairs met in Washington for the first China-US consultation on Asia-Pacific affairs.

Greater China Indices	Sep Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	3689.52	-2.01	-4.70	3495.95	4268.15
MSCI China	58.71	-3.07	-8.93	47.43	75.86
HSI	17809.66	-3.11	-9.97	14597.31	22700.85
HSCEI	6148.33	-2.91	-8.30	4919.03	7773.61
Global Indices					
S&P 500	4288.05	-4.87	11.68	3491.58	4607.07
Dow Jones Industrial Average	33507.50	-3.50	1.09	28660.94	35679.13
Nasdaq Composite	13219.32	-5.81	26.30	10088.83	14446.55
FTSE 100	7608.08	2.27	2.10	6707.62	8047.06
DAX 30	15386.58	-3.51	10.51	12000.43	16528.97
Nikkei 225	31857.62	-2.34	22.09	25661.89	33772.89

Economic Data

China's manufacturing PMI index rose to 50.2 in Sep from 49.7 in Aug, returning to the expansion range. The new orders sub-index rose to 50.5 in Sep from 50.2 in Aug, while the output sub-index rose to 52.7 in Sep from 51.9 in Aug. Production and exports showed supra-seasonal marginal improvements. The non-manufacturing PMI index rose to 51.7 in Sep from 51.0 in Aug. The construction industry sub-index rose to 56.2 from 53.8 in August, mainly due to the diminished impact of severe weather. The services sub-index rose to 50.9 in Sep from 50.5 in Aug. The PMIs of service industries such as water transport, postal, telecommunication and internet software were above 55 According to the survey.

Outlook

Looking forward, we maintain our long-term positive view on China equity market. The fundamentals of China's manufacturing industry are recovering. As macro policies take further effect and coupled with marginal improvements in y-o-y export growth, the y-o-y inventory growth

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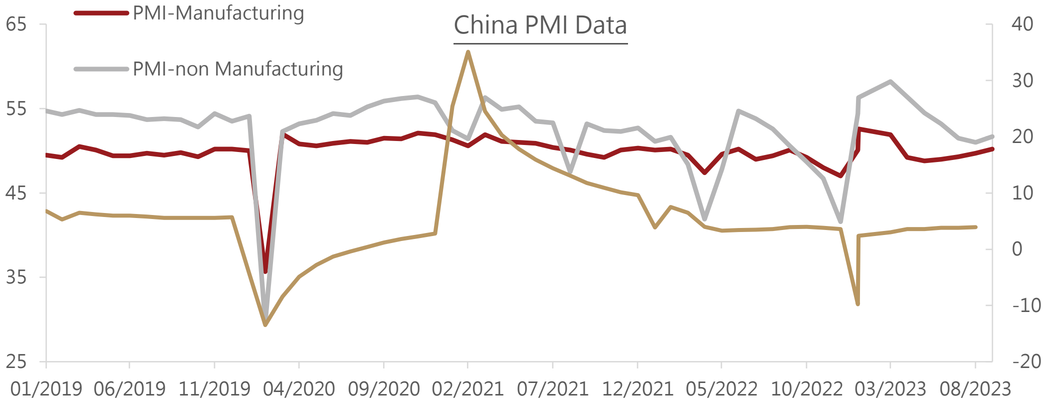
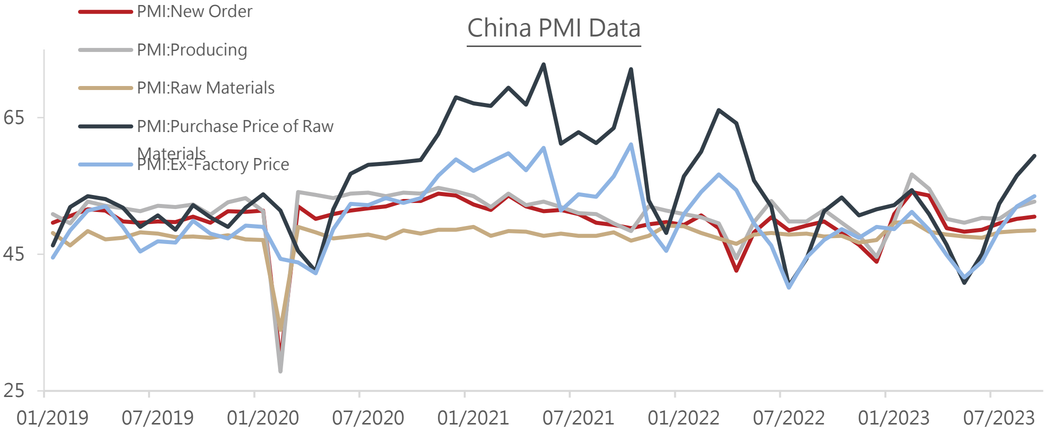
rate may reach its bottom in the fourth quarter. We anticipate that more effective polices will be introduced in the upcoming Politburo meeting in mid-Oct and the Third Plenum this Oct/Nov. We will closely monitor US-China relations to see whether it will continue to stabilize, and the market impact of the rising US bond yields due to the more hawkish stance of the Fed Reserve. 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.





In September, markets continued to be volatile, with Treasury yields hitting new highs since 2008 and maintaining a steep curve. The Fed officials' economic forecasts also reinforced the notion that achieving a "soft landing" for the economy is not impossible. Among these forecasts, the GDP for 2023 was revised upward to 2.1%, the unemployment rate was revised downward to 3.8%, and the core PCE was revised downward to 3.7%. Against the backdrop of the US economy outperforming China and Europe, the US dollar strengthened, while overall risk sentiment was somewhat restrained due to the postponement of rate cuts expectations. Looking at the entire month, most major asset classes declined, with bonds outperforming stocks, and crude oil performing well due to demand factors.

Market Performance

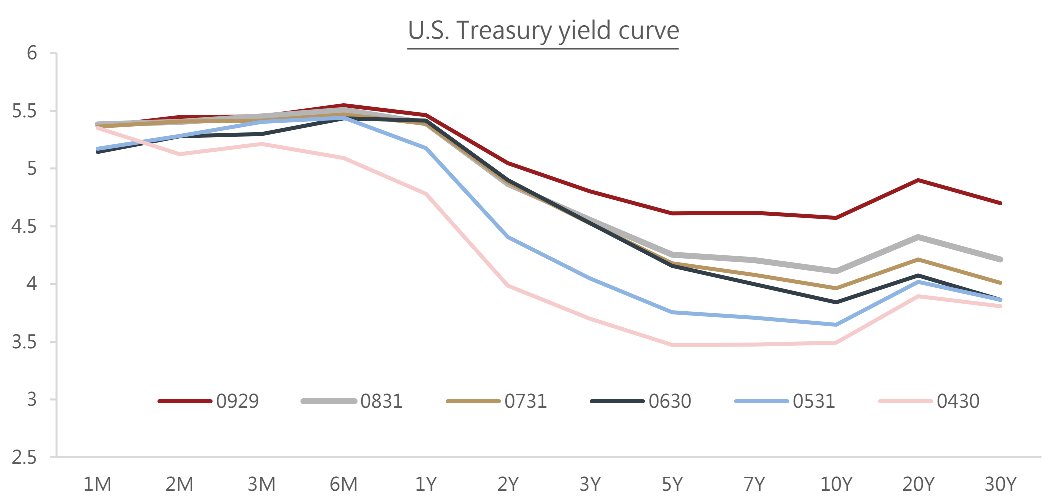
In September, markets continued to be volatile, with Treasury yields hitting new highs since 2008 and maintaining a steep curve. The Fed kept the benchmark interest rate unchanged at its September meeting, with the dot plot showing a median rate of 5.625% by the end of the year and 5.125% by the end of 2024, which represents a 50 basis point increase from June data. It seems that maintaining high interest rates in the long term has become a consensus. The Fed officials' economic forecasts also reinforced the notion that achieving a "soft landing" for the economy is not impossible. Among these forecasts, the GDP for 2023 was revised upward to 2.1%, the unemployment rate was revised downward to 3.8%, and the core PCE was revised downward to 3.7%. Against the backdrop of the US economy outperforming China and Europe, the US dollar strengthened, while overall risk sentiment was somewhat restrained due to the postponement of rate cuts expectations. Looking at the entire month, most major asset classes declined, with bonds outperforming stocks, and crude oil performing well due to demand factors.

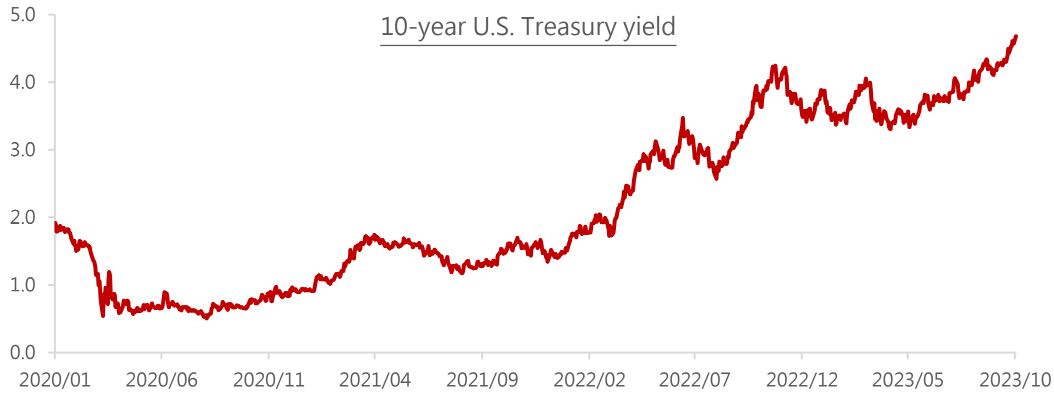
United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	5.04	18	62	3.55	5.20
5Y	4.61	35	61	3.20	4.87
7Y	4.61	41	65	3.24	4.91
10Y	4.57	46	70	3.25	4.89
30Y	4.70	49	74	3.40	5.05

China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.38	16	-4	2.18	2.57
5Y	2.53	13	-10	2.34	2.77
7Y	2.70	13	-12	2.51	2.91
10Y	2.68	10	-16	2.54	2.96
30Y	2.99	9	-21	2.88	3.32

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	0.05	2	1	-0.09	0.07
5Y	0.32	9	8	0.05	0.34
7Y	0.52	12	7	0.08	0.62
10Y	0.77	11	34	0.18	0.81
30Y	1.73	6	12	1.11	1.84

Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	3.20	23	44	1.77	3.38
5Y	2.78	30	20	1.74	2.93
7Y	2.79	34	22	1.74	2.94
10Y	2.84	37	27	1.74	3.03
30Y	3.04	44	49	1.60	3.26





In the corporate bond market, headlines remained on the US Congress, which approved short-term funding at the end of the month, successfully avoiding a government shutdown and providing funding to maintain current government expenditure levels until mid-November. This decision has caused dissatisfaction among some conservative factions within the Republican Party, leading to the removal of House Speaker McCarthy. It remains to be seen whether the two parties can reach a consensus on the spending bill before mid-November, which could disrupt US economic data. Moody's has issued a warning regarding the US government's credit rating due to the government shutdown. As of mid-September, the credit spreads of investment-grade bonds in the US have narrowed slightly, but with weakening risk sentiment and increased supply of US bonds, US bond yields have reached new highs. In late September, credit spreads widened, not only reversing the narrowing trend in the first half of the month but also showing weakness compared to the beginning of the month. Chinese offshore dollar bonds performed well this month, with large spreads due to limited supply, which have generally narrowed. Short-term investment-grade bonds continued to be in demand, resulting in significant spread narrowing compared to the beginning of the month. There were no significant changes in the high-yield real estate sector, and sentiment remained weak. The AMC sector performed well overall, boosted by positive news on share buybacks. Chinese investment-grade dollar bonds fell by 0.7% for the month, while high-yield bonds rose by 0.6%.

CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	74	10	(8)	62	109
HY CDX	481	55	(3)	400	625
EM CDX	226	25	75	188	344
Bond index					
ICE Asian Dollar Corporate	421	-0.8%	1.1%	384	432
ICE China Issuers Dollar IG Corporate	200	-0.7%	1.7%	185	204
ICE China Issuers Dollar HY Corporate	148	0.6%	-23.4%	115	218
ICE US Corporate	3001	-2.5%	0.4%	2809	3133
ICE US High Yield	1485	-1.2%	6.0%	1351	1503
ICE Emerging Markets Corporate	408	-1.2%	1.6%	373	417
Bloomberg Global-Aggregate	436	-2.9%	-2.2%	416	467
Bloomberg Global-Aggregate 1-3 Year	167	-1.1%	-0.4%	159	171

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Economic Data

US economic data is mixed. The unemployment rate has risen, non-farm employment has increased, and the labor force participation rate has also risen. In terms of inflation, core CPI growth has slowed on a year-on-year basis, while energy prices have risen, transmitting to other sectors of the economy. However, the growth rate of the core CPI remains strong, and the annualized growth rate of core PCE in the second quarter was 3.7%, indicating a certain degree of inflation slowdown. In terms of economic growth, the annualized growth rate in the second quarter was 2.1%, which is not significantly different from the first quarter. However, consumer spending in the second quarter only grew at an annualized rate of 0.8%, reflecting a certain degree of consumer weakness. It seems that high interest rates have started to drag down consumer purchasing power. It is necessary to pay attention to economic growth in the third and fourth quarters, whether it can continue to maintain or exceed expectations. Overall, economic growth is stable, core inflation is slowing down, and consumer spending is weak. The maintenance of high interest rates still requires strong economic data as support. If inflation rises unexpectedly and economic growth continues to remain high, there may still be another rate hike at the end of the year. In Europe, economic growth slowed in the second quarter, and the pace of inflation has also slowed. The rate hike in September slightly exceeded expectations, but it is highly likely that this round of rate hikes is coming to an end. In Japan, the economy showed strong growth in the second quarter, inflation remained high, and government bond yields reached new highs.

In terms of China policies, the central bank has lowered the reserve requirement ratio for foreign exchange deposits by 2%, from 6% to 4%, in order to enhance the ability of financial institutions to utilize foreign exchange funds. This is mainly achieved by releasing a portion of the foreign exchange deposits held by financial institutions at the central bank, thereby increasing foreign currency supply and supporting the yuan. The central bank has also lowered the reserve requirement ratio for deposits by 0.25%, in line with market expectations for a reserve ratio cut in the third quarter. The MLF (Medium-Term Lending Facility) rate remains unchanged, although adjustments are expected in the fourth quarter, likely around ten basis points. The LPR (Loan Prime Rate) remains unchanged as well. The issuance of 15 billion yuan of six-month treasury bills was conducted overseas, with 10 billion yuan being additional issuance. Additionally, 5 billion yuan of government bonds were issued in Macau, with 4 billion yuan being for a two-year term and 1 billion yuan for a five-year term. In the real estate sector, multiple governmental departments have jointly promoted the implementation of the policy measure of "recognizing the property but not the loan" for first-time homebuyers' loans. Different housing credit policies have been adjusted and optimized, including changes to down payment ratios and interest rates for existing first-time homebuyer loans. Data-wise, the official manufacturing PMI for August came in at 49.7, higher than the expected 49.2. The Caixin manufacturing PMI for the same period was 51, surpassing the expected 49.3. However, the Caixin services PMI for August was lower than expected. Both import and export volumes were higher than expected, but the net export volume was lower than expected. Both PPI and CPI inflation levels saw a rebound on a month-on-month basis. Social financing, fixed investment, retail sales, industrial production data, and profits of industrial enterprises above designated size all showed improvement. Overall, the data has confirmed improvement and a bottoming out, but there hasn't been a significant rebound in RMB-related assets, mainly due to market caution regarding the extent of future economic data improvement.

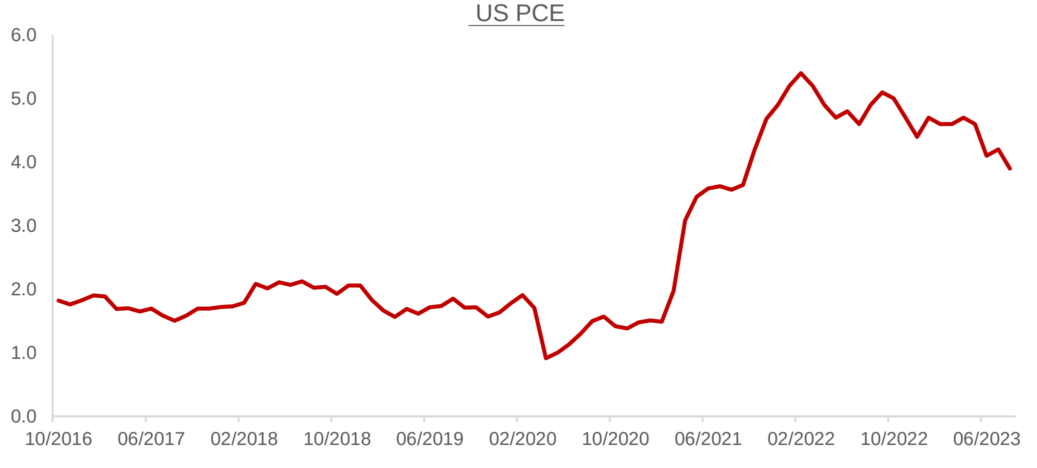
The spot USDCNH exchange rate edged up from 7.28 to 7.30, briefly reaching 7.37 before quickly retracing back to 7.30. Overall, the spot rate has been primarily characterized by range-bound volatility, largely influenced by tightening liquidity conditions. It is important to note that the US dollar has remained strong this month, rising for eleven consecutive weeks. Therefore, the yuan has shown resilience compared to G10 currencies at this level, but it still faces significant pressure from the US dollar in the near future. The funding conditions for swaps have remained relatively tight, primarily due to the central bank's efforts to curb arbitrage activities. At the end of the month, the central bank also utilized regular 14-day reverse repos and increased reverse repo operations to support liquidity during the extended holiday period. The entire yield curve has moved upward in line with funding conditions, with an inverted shape observed in implied interest rate differentials. Onshore and offshore swap levels also exhibit significant discrepancies. In the recent period, the impact of funding conditions remains greater than the China-US interest rate differential. The interest rate swap curve has moved up by approximately 10 basis points, driven mainly by bond supply and demand dynamics and fiscal stimulus. Government bond yields have also risen, although the increase has been less significant on the longer end, such as the ten-year yield, compared to the interest rate swaps. This suggests that there is more demand for government bonds from real money investors.

Outlook

September economic data showed divergence. The US economy experienced strong growth, with increased job demand while unemployment rate within expectations. Inflation growth slowed down, consumer spending decelerated, and new home construction fell below expectations. The Federal Reserve skipped a rate hike in September, but the dot plot suggests another rate hike by year-end and potentially fewer rate cuts next year. The US fiscal deficit has worsened, and the Fed is reducing its holdings of Treasuries. The substantial increase in financing needs by the Treasury in the third quarter has led to increased Treasury supply. Treasury yields remain high and continue to hit previous highs. The financing needs for the fourth quarter have not been announced yet, but if there is a significant increase, coupled with the Fed's ongoing balance sheet reduction, it will be difficult for US Treasury yields to retreat from their high levels in the short term. Expectations are for continued volatility in the near term, and the yield curve may steepen further. Market opinions on whether there will be another rate hike by year-end remain divided. Despite still being below the inflation target, recent economic data has shown signs of slowing consumer spending and wage growth. Therefore, a rebound in inflation may be needed for another rate hike, or else an early rate cut could be triggered even if there is a rate hike by year-end. Currently, the alignment between the Fed's monetary policy and economic trends remains intact, and risk sentiment is weak albeit manageable. In Europe, the benchmark interest rate was raised by 25 basis points in September to address high inflation, exceeding market expectations. This move also suggests the end of the current rate hike cycle. The European economy still faces significant challenges. Japanese government bond yields continue to hit previous highs, and it is necessary to monitor the impact of subsequent monetary policy adjustments and their negative effects on US bonds. Emerging markets show significant divergence in economic and inflation trends.

In the credit market, spreads have been influenced by persistent weak risk sentiment, the maintenance of high long-term interest rates, increased supply, and the continued strength of the economy, resulting in range-bound volatility. September saw an increase in new corporate bond issuance, mainly in the short to medium term, with issuers offering attractive issue premiums. The high interest rates have significantly increased financing costs for US corporations, and investors have shown interest in purchasing high-rated bonds with good issue premiums. The high interest rates have also increased the risk of losses for the banking sector, leading to weaker performance compared to sectors such as technology and energy, resulting in a slight widening of credit spreads. Going forward, attention should be paid to the possibility of tail risk events. It is expected that corporate bond issuance will not be significant in October, and economic data and US Treasury yields will continue to impact credit spreads. It is anticipated that credit spreads will continue to fluctuate within a range by year-end, with a steep yield curve for higher-rated issuers. Against this backdrop, defensive sectors in the US non-financial non-cyclical space are relatively favored. In the case of Chinese issuers, credit spreads narrowed significantly in September, supported by the technical aspects of SOEs and the performance of the TMT sector. The month saw a slight improvement in real estate sales on a month-on-month basis, but the recovery remains fragile, warranting caution in this sector. Some short-term and high-quality issuers in the LGFV sector offer significant premiums compared to onshore bonds, making them attractive for investment. From an absolute yield perspective, corporate bonds, especially short-term bonds, offer some investment value. If yields decline significantly, it may be prudent to consider taking profits and capturing volatility opportunities. We still prefer higher-rating credits and maintain flexibility and diversification for portfolio allocations.

For the yuan in October, it is still worth anticipating further improvement in economic data, but the key lies in the efficiency of the positive transmission of these improvements to asset prices, which may require more time to gain market consensus. In terms of liquidity, it is expected to remain relatively tight. Based on the announced and historical seasonal issuance of local government bonds and government bonds, the net financing amount is expected to remain relatively large. According to seasonal fiscal revenue and expenditure patterns, as it is the beginning of the quarter, revenue is expected to exceed expenditure. Therefore, swap yields and short- to medium-term Chinese interest rates are likely to trend upward. The yuan is currently benefiting from tightening liquidity conditions and support from the central bank, but the US dollar and US interest rates remain strong. In terms of policy, there may be another small (10 basis points) interest rate cut in monetary policy, while fiscal policy is expected to maintain a loose credit environment and continue to support lending. Market expectations are for further relaxation of real estate policies in core areas of first-tier cities.



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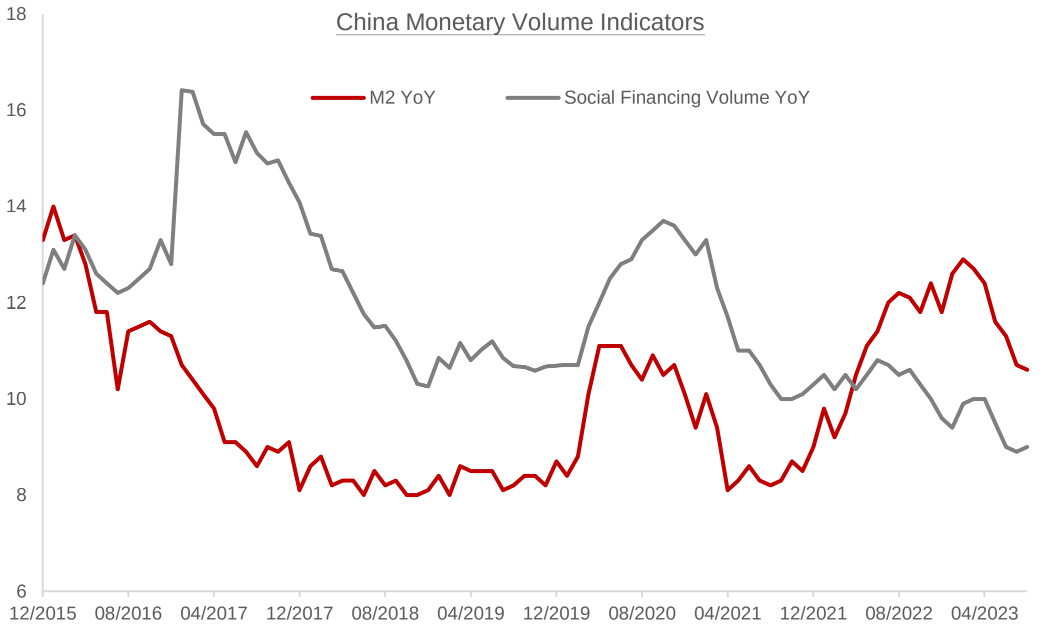

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