MARKET INSIGHTS

Dovish Fed Signs Triggered Risk-On Rally

December 2023

Equity

MSCI China index raised by 2.28% in the month of November, which put an end to the continuous decline lasted for months. Policies proactively responded to the property slowdown. We believe domestic policy support will continue, especially with important events such as the year-end Politburo meeting and the Central Economic Work Conference on the horizon. For example, recent measures in the real estate sector have further supported financing for property developers, and Shenzhen has introduced new demand support policies. The significant appreciation of the Chinese yuan and the meeting between Xi and Biden provide an early buffer space for potential pressures going forward.

Market Performance

MSCI China index raised by 2.28% in the month of November, which put an end to the continuous decline lasted for months. Policies proactively responded to the property slowdown. PBoC will reportedly introduce 1trn yuan low-cost funding via PSL for urban village and public housing. Select tier 1 and 2 cities cut downpayments on second homes and others removed price controls for land auctions. A whitelist of 50 developers was reported to be in the works for funding support. On Nov 15, President Xi Jinping and President Joe Biden met at the Asia-Pacific Economic Cooperation event, which eased expectations regarding the China-US relationship.

Greater China Indices	Nov Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	3496.20	-2.14	-9.70	3450.65	4268.15
MSCI China	57.43	2.28	-10.92	54.74	75.86
HSI	17042.88	-0.41	-13.84	16617.03	22700.85
HSCEI	5857.54	-0.07	-12.64	5692.24	7773.61
Global Indices					
S&P 500	4567.80	8.92	18.97	3764.49	4607.07
Dow Jones Industrial Average	35950.89	8.77	8.46	31429.82	36264.85
Nasdaq Composite	14226.22	10.70	35.92	10207.47	14446.55
FTSE 100	7453.75	1.80	0.03	7206.82	8047.06
DAX 30	16215.43	9.49	16.46	13791.52	16528.97
Nikkei 225	33486.89	8.52	28.33	25661.89	33853.46

Economic Data

China's manufacturing PMI index edged down to 49.4 in Nov from 49.5 in Oct. The output and new orders sub-index declined to 50.7 and 49.4 from 50.9 and 49.5 in Oct, respectively. The decline in manufacturing PMI was linked to insufficient market demand and some manufacturing industries entering off-season period. The non-manufacturing PMI fell to 50.2 in Nov from 50.6 in Oct. The services PMI decreased to 49.3 in Nov from 50.1 in Oct partly due to a high base caused by National Day golden week. The PMIs of service industries such as water transport, telecommunication and satellite transmitter were above 55, while the PMIs of real estate, rental and business services were below 50. The construction PMI increased to 55.0 in Nov from 53.5 in Oct because the speed of infrastructure project construction maintained solid in November.

Outlook

Looking forward, we maintain our long-term positive view on China equity market. Currently, the valuation of the Chinese stock market is at historical lows, and we believe that a corrective rebound will have some support as we approach the end of the year. Domestic policy support will continue, especially with important events such as the year-end Politburo meeting and the Central Economic Work Conference on the horizon.

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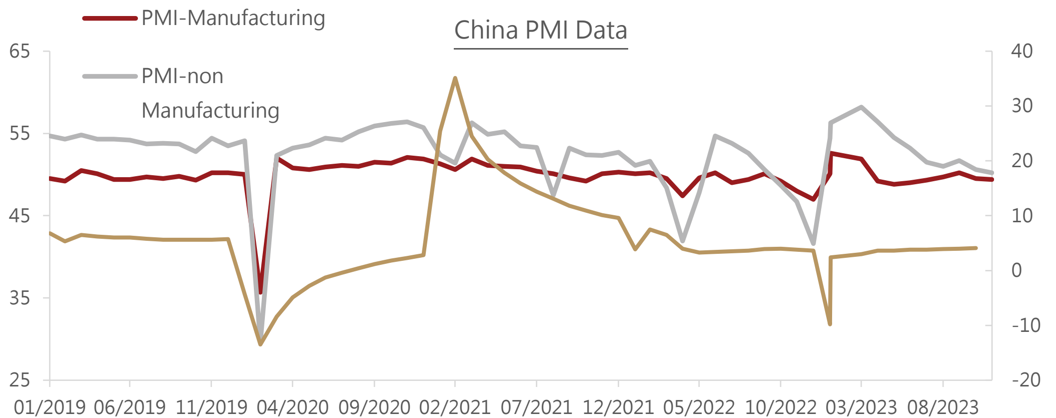
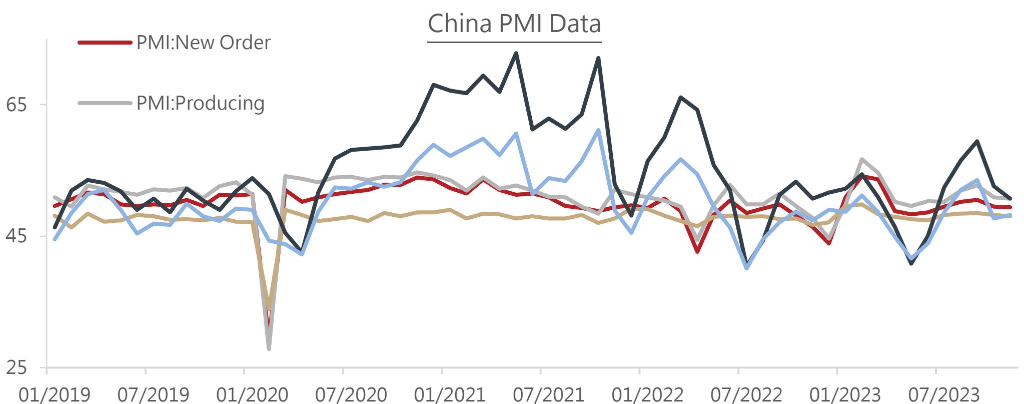
We continue to focus on the long-term policy beneficiaries (eg. software localization and advanced manufacturing), short-term policy beneficiaries (property and property-related sectors) and reopening-related opportunities (eg. consumer, Internet and financials). We will prudently pay attention to some thematic opportunities, including AI and SOE re-rating. We will also track property sales stabilization, senior level US/China economic communication, and upbeat GDP target and guidance on incremental easing at the December Central Economic Work Conference.

Risk

Sino-US relationship worsens than expectation. International geopolitics worsens than expectation; China's economy recovers less than expected.





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Markets remained volatile in October, with the 10-year US Treasury yield fluctuating in the first half of the month. The U.S. Treasury Department's quarterly financing plan shows that the issuance of long-term bonds is currently lower than expected, leaving room for adjustments based on market conditions. Economic data will continue to be the main driver for Treasury yield fluctuations. It is expected that the yield curve will remain steep, while the short end of the curve, influenced by the approach of the end of the rate hiking cycle, has a greater chance of falling back from the high range. The long end of the curve is affected by a tight financial environment, the financing pressure of enterprises, and the high level of inflation maintaining for a short time. The long-term yield will continue to fluctuate in the high range, with limited downside space.

Market Performance

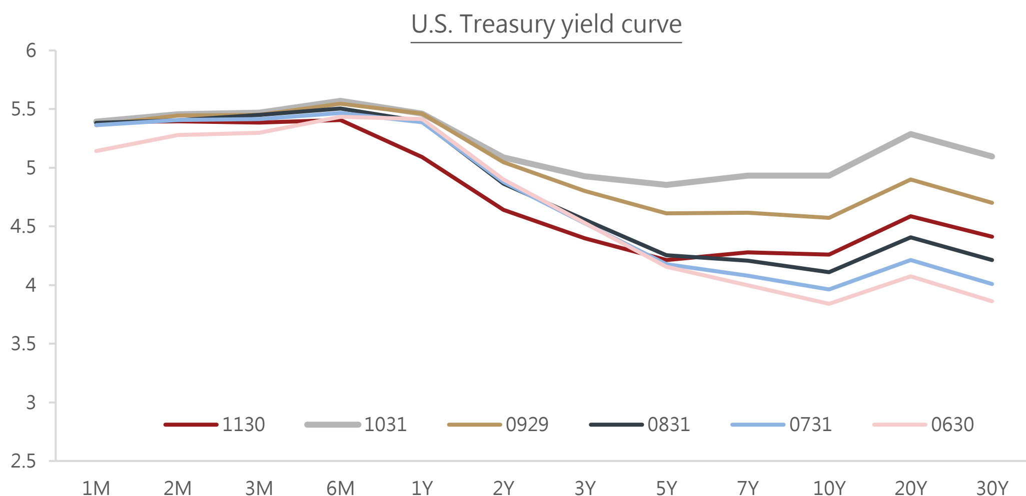
In November, the bond market experienced wide fluctuations, with interest rates trending downward. The decline in US Treasury yields exceeded that of other regions such as Europe and Japan. Currently, the futures market expects that the Federal Reserve will not raise interest rates in December, and there will be a cumulative interest rate cut of approximately 50 basis points in mid-June next year, with a cumulative interest rate cut of approximately 125 basis points by the end of next year. In terms of major asset classes, both stocks and bonds recorded positive returns, with stocks outperforming bonds. Investment-grade credit bonds and EM market sovereign bonds outperformed high-yield bonds. Commodities showed mixed performance, with crude oil declining and gold rising.

United States	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	4.68	-41	25	3.55	5.26
5Y	4.27	-59	26	3.20	4.99
7Y	4.34	-59	38	3.24	5.03
10Y	4.33	-60	45	3.25	5.02
30Y	4.49	-60	53	3.43	5.18

China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.47	5	5	2.18	2.57
5Y	2.57	3	-5	2.34	2.77
7Y	2.67	-2	-15	2.51	2.89
10Y	2.69	-1	-15	2.54	2.94
30Y	2.95	-5	-26	2.88	3.32

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	0.03	-12	-1	-0.09	0.18
5Y	0.26	-20	3	0.05	0.49
7Y	0.43	-26	-2	0.08	0.73
10Y	0.67	-28	25	0.18	0.97
30Y	1.66	-21	5	1.11	1.91

Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	2.82	-20	5	2.08	3.38
5Y	2.37	-28	-20	1.86	2.93
7Y	2.37	-32	-20	1.83	2.94
10Y	2.45	-36	-12	1.85	3.03
30Y	2.69	-41	14	1.66	3.26



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In November, the US Treasury yield curve flattened. Credits performed well, with investment-grade spreads experiencing a rapid decline. The spreads narrowed to their lowest levels of the year, and the spread curve appeared noticeably flat. High-yield credit bonds also saw significant price increases. The main reasons for this performance include a significant decline in US Treasury yields, cautiously dovish signals from Fed official, and market expectations of earlier and larger interest rate cuts next year. Additionally, the US economic data remains relatively strong, with expectations that the supply of credit bonds will decrease in the near future, resulting in less pressure on spreads.

Chinese investment-grade US dollar bonds issued by Chinese entities also saw a significant narrowing of spreads this month. The TMT sector benefited from better-than-expected performance and positive rating outlooks, leading to a narrowing of spreads to year-to-date lows. Some companies chose to repurchase existing US dollar bonds at market prices to boost market sentiment, while some banking institutions issued new bonds at low spreads to replace maturing bonds, further boosting market sentiment due to widespread investor demand. The Chinese high-yield sector also experienced significant gains this month, with the real estate sector exhibiting higher volatility and fragile sentiment, making new issuances challenging. Throughout the month, Chinese investment-grade bonds rose by 3.3%, while high-yield bonds rose by 5.5%.

In November, policy rates remained unchanged, with a net increase of 600 billion yuan in Medium-Term Lending Facility (MLF). Fiscal policy continued to maintain incremental issuance of bonds and debt conversion. Economic data showed moderate performance. The domestic funding market saw the overnight Shanghai Interbank Offered Rate (SHIBOR) climb 10 basis points to 2.5%, while the DR007 rose from 1.8% to 2.2%. The increase in bond supply was the primary factor. With the end of the year approaching and the issuance of bonds for the year nearing completion, combined with reduced immediate pressures, it is not ruled out that there may be reserve requirement ratio cuts, interest rate reductions, and targeted Medium-Term Lending Facility (PSL) injections. In the past month, economic data has been relatively weak, and despite the overall rise in global stock markets, Chinese concept stocks have continued to decline. It is expected that the funding situation will ease by the end of the year, leading to a downward movement in entire government and policy bank bond yield curve. The support levels for the 10-year government yield and China Development Bank yield are expected to be around 2.65% and 2.5%, respectively.

The USD/CNH spot rate experienced a downward trend from 7.35 to 7.15, driven primarily by weakness in the US dollar. It is expected to fluctuate within the range of 7.13 before the end of the year. To see a further decline to the 7.00 level, positive news in the real estate sector would be a prerequisite. The offshore forward rate curve followed the spot rate downward, mainly influenced by forward exchange settlement positions. Currently, its correlation with the domestic funding market and the China-US interest rate differential has weakened. The view is maintained that it will continue to trend lower before the end of the year.

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CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	62	(17)	(20)	61	94
HY CDX	402	(114)	(81)	395	554
EM CDX	187	(41)	36	183	275
Bond index					
ICE Asian Dollar Corporate	433	3.6%	3.9%	416	437
ICE China Issuers Dollar IG Corporate	205	3.3%	4.4%	196	207
ICE China Issuers Dollar HY Corporate	152	5.5%	-21.0%	143	218
ICE US Corporate	3113	5.6%	4.2%	2929	3164
ICE US High Yield	1534	4.5%	9.4%	1401	1547
ICE Emerging Markets Corporate	419	4.0%	4.5%	401	423
Bloomberg Global-Aggregate	453	5.0%	1.5%	429	467
Bloomberg Global-Aggregate 1-3 Year	171	2.6%	2.2%	166	171

Economic Data

The US economy exhibited strong growth in the third quarter, with signs of inflation slowing down, as both employment and consumer income and spending showed signs of deceleration. The US GDP grew at an annualized rate of 5.2% in the third quarter, a rate that is unlikely to sustain into the fourth quarter. The full-year economic growth for 2023 is expected to exceed 2%. In terms of employment, the unemployment rate reached 3.9% in October, the highest level since the start of the rate-hike cycle. There is a possibility that the unemployment rate will remain high or even increase further, as leading indicators such as the ISM Services and Manufacturing PMI employment indices have shown two consecutive months of slowing employment. Nonfarm payrolls added only 150,000 jobs in October, indicating a slowdown. Personal income and spending both grew at a monthly rate of 0.2% in October, reflecting signs of sluggishness in consumer spending growth. In terms of inflation, core PCE increased by 3.5% year-on-year in October, reaching a nearly two-year low. At the same time, core CPI increased by 0.2% on a monthly basis and 4% year-on-year, showing a continuous slowdown in growth. With inflation slowing down and the job market cooling, the market expects that inflation is one step closer to the Fed's target, and currently, there is no need for additional rate hikes. Sales data showed that retail growth slowed down in October, and growth in new and existing home sales also slowed down, reflecting the slowdown in consumption due to high borrowing costs and cooling employment. The November FOMC meeting and recent speeches by Fed officials have acknowledged the restrictive effect of the 525 basis points of rate hikes over the past year on inflation, while leaving room for adjustments in interest rates based on future data. In Europe, the effect from high interest rates is more pronounced, as core CPI has shown consecutive slowdowns in year-on-year growth, and the eurozone's GDP contracted by -0.1% on a quarterly basis in the third quarter, with weak year-on-year growth of only 0.1%. The interest rate swap market expects a more than 50% chance of a 25-basis point rate cut in the Eurozone in March next year. Japan's GDP contracted by -0.5% on a quarterly basis in the third quarter, leading to a decline in interest rates.

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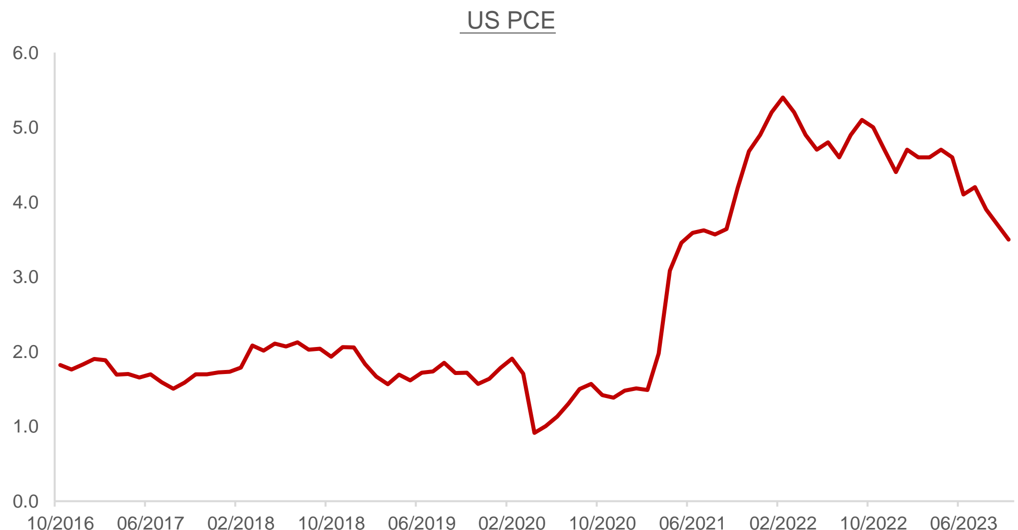
Outlook

In November, the market was relatively optimistic, with both bonds and stocks recording positive returns. Looking ahead, US economic growth in the fourth quarter is expected to slow down, with a lower growth rate compared to the third quarter. Economic growth is likely to further decelerate next year. Fed Chair Powell referred to policy current rates as being "well into restrictive territory," leading the market to believe that the current cycle of interest rate hikes is coming to an end. Both data and statements from some Fed officials have confirmed that higher interest rates are effectively curbing inflation. The duration of maintaining high interest rates and the timing of a potential interest rate cut by the Federal Reserve largely depend on when inflation subsides and approaches its target level, or when economic growth faces potential recessionary pressure from high interest rates. At this stage, close attention should be paid to employment data, including the unemployment rate, nonfarm payrolls, as well as changes in month-on-month growth of the Personal Consumption Expenditures (PCE) and Consumer Price Index (CPI), in order to gauge the timing of potential interest rate cuts cautiously. Currently, the market expects a 50-basis point cut in interest rates by the middle of next year, followed by a total reduction of 125 basis points by the end of next year. US bond yields are expected to decline further, leading to a steeper yield curve. In the Eurozone, economic growth contracted in the third quarter, indicating the potential for further decline in interest rates.

The spreads of US investment-grade bonds have narrowed to their lowest levels of the year. Going forward, the spreads are expected to fluctuate, with a possibility of widening. However, the likelihood of a rapid and significant widening is relatively low, as the Federal Reserve has significant room for interest rate cuts in the event of an economic downturn, and the US economy has shown greater resilience compared to other countries. Additionally, there is still broad demand for US investment-grade bonds due to their relatively high yields. The spread curve of US investment-grade bonds is currently relatively flat, at historically low levels. In the Chinese sector, due to limited new issuance, there is still demand for high-grade bonds, with spreads persisting at tight levels. However, there is a possibility of widening spreads for high-beta bonds, and caution should be exercised when considering the real estate sector. There may be opportunities to increase holdings of long-duration, high-rated bonds selectively. Non-cyclical sectors continue to offer attractive yields, while the spreads of cyclical sectors may experience greater volatility and a potential widening. It is essential to maintain caution and conduct comprehensive analysis while considering the fundamentals of the issuers.



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