華夏基金(香港)
ChinaAMC (HK)

MARKET INSIGHTS

A Divergence of global markets

January 2024

Equity

MSCI China index dropped by 2.58% in the month of December. The CEWC proposed that proactive fiscal policies should be moderately intensified and aimed at improving quality and efficiency. We see domestic policies remain the primary driving force behind market trends in 2023. We anticipate that more timely and forceful fiscal policies will emerge this year, and they will make positive impacts on market sentiment. we will continue to seek a balance between value and growth. We continue to focus on the long-term policy beneficiaries, short-term policy beneficiaries, and reopening-related opportunities.

Market Performance

MSCI China index dropped by 2.58% in the month of December. The CEWC has clarified the focus of next year's economic work, emphasizing high-quality development and the principle of establishing priorities and solving problems incrementally. Fiscal and monetary policies will continue to be strengthened, although the intensity is slightly lower than market expectations. Property and LGFV risks are still unfolding. The market was discouraged by a moderating M1 y-o-y, worse-than-expected retail sales, and a CPI that had yet again turned negative y-o-y. Many investors were also puzzled by the rationale and timing of the draft regulation regarding online gaming on Dec 22.

Greater China Indices	Dec Close	Monthly % Change	YTD %	52 Week Low	52 Week High
CSI 300	3431.11	-1.86	-11.38	3283.99	4268.15
MSCI China	55.95	-2.58	-13.22	53.16	75.86
HSI	17047.39	0.03	-13.82	15972.31	22700.85
HSCEI	5768.50	-1.52	-13.97	5443.60	7773.61
Global Indices					
S&P 500	4769.83	4.42	24.23	3802.42	4793.30
Dow Jones Industrial Average	37689.54	4.84	13.70	31429.82	37790.08
Nasdaq Composite	15011.35	5.52	43.42	10265.04	15150.07
FTSE 100	7733.24	3.75	3.78	7206.82	8047.06
DAX 30	16751.64	3.31	20.31	14264.60	17003.28
Nikkei 225	33464.17	-0.07	28.24	25661.89	33853.46

Economic Data

China’s manufacturing PMI fell to 49.0 in December. The new order sub-index declined to 48.7 in December from 49.4 in November, and the output sub-index declined to 50.2 from 50.7 in November. The NBS commented that the decline in manufacturing PMI was linked to some raw materials industries entering the off-season period and also noted that decreasing overseas orders and insufficient domestic demand are the main challenges faced by some surveyed enterprises. The non-manufacturing PMI rose to 50.4 in December from 50.2 in November. The construction PMI increased to 56.9 in December from 55.0 in November, with the NBS mentioning that some enterprises increased the speed of infrastructure project construction ahead of the Chinese New Year holiday. The services PMI remained unchanged at 49.3 in December. Postal, telecommunication and satellite transmission were above 55 while the PMIs of water transport, airline and hotel services were below 46, partly due to adverse weather conditions.

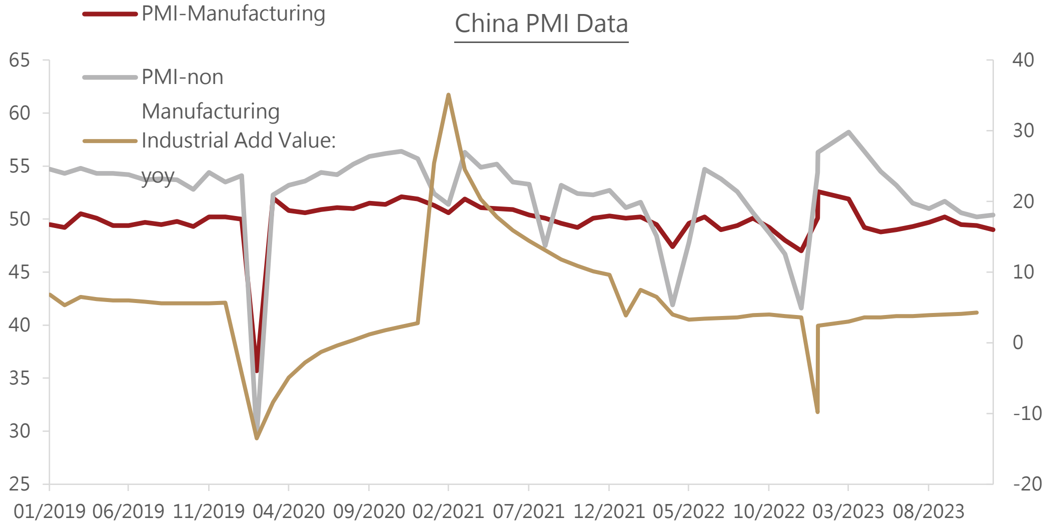
Outlook

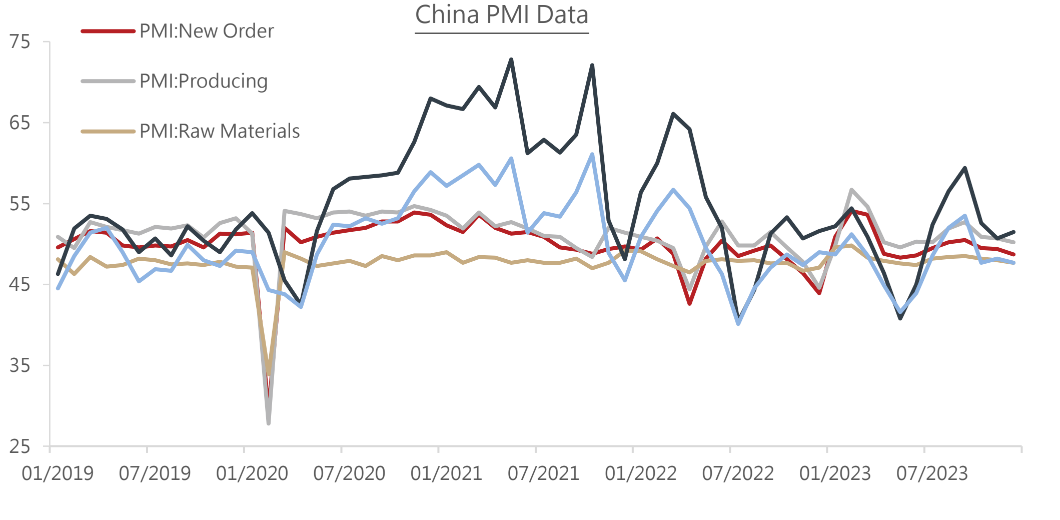
Looking forward, we maintain our long-term positive view on China equity market. The CEWC proposed that proactive fiscal policies should be moderately intensified and aimed at improving quality and efficiency. In comparison to the July Politburo meeting, there has been a slight change in the tone of monetary policy, shifting from "precise and forceful" to "precise and effective." The total outstanding of the PBOC's Pledged Supplementary Lending (PSL) program increased by RMB350bn in December, suggesting that the media-reported PSL-backed urban village renovation and public housing construction are starting. Beijing approved 105 domestic games on Dec 25, just a few days after the online gaming regulation draft was published, to help stabilize confidence. From the market context in 2023, we see domestic policies remain the primary driving force behind market trends. We anticipate that more timely and forceful fiscal policies will emerge this year, and they will make positive impacts on market sentiment.

In terms of portfolio positioning, 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). We will prudently pay attention to some thematic opportunities, including AI and SOE re-rating.

Risk

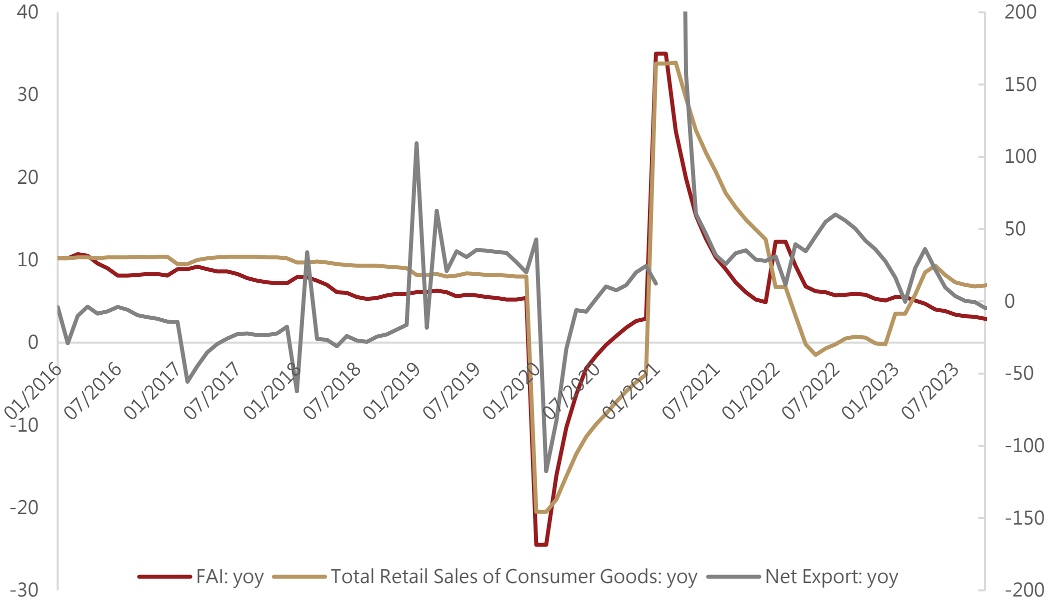
Sino-US relationship worsens than expectation. International geopolitics worsens than expectation; China's economy recovers less than expected.





Equity

China Economy Activities



In December, the US bond market experienced significant volatility, with US Treasury yields continuing their substantial decline from November. Overall, we maintain a neutral view on the US economy for 2024. Economic growth is expected to moderate but should avoid a severe recession barring any black swan events. The pace of credit contraction is a key indicator to monitor, and there are two risk points to be cautious of. Currently, we remain cautious on duration, and stay alert to the potential reversal of the extremely optimistic trading logic seen in the market over the past two months, which could lead to asset price corrections.

Market Performance

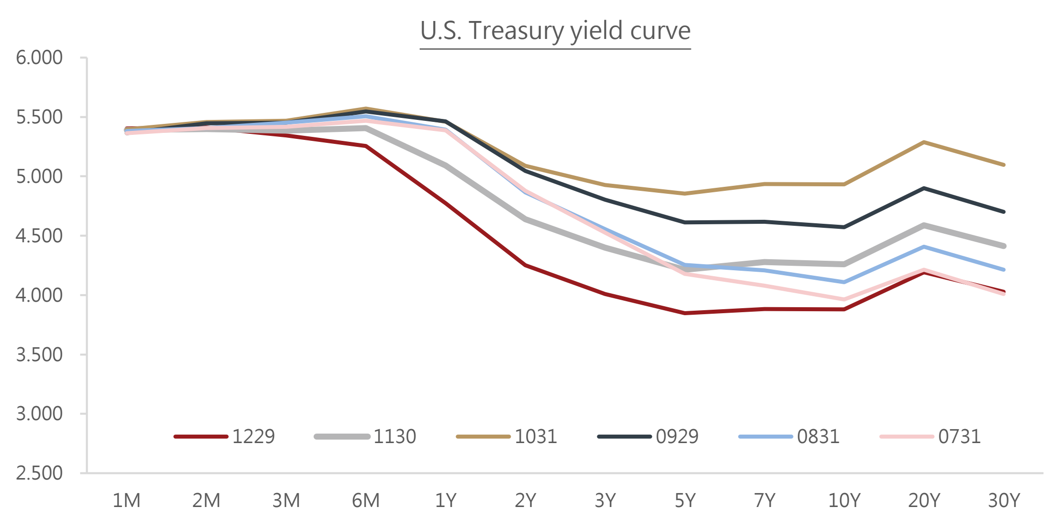
In December, the US bond market experienced significant volatility, with US Treasury yields continuing their substantial decline from November. The decline in yields was relatively consistent across tenors, with short- to medium-term bond yields paring back their year-to-date increases. Interest rates in major European countries also saw noticeable decreases, while Japanese government bonds experienced a slight decline, albeit with significant fluctuation. Currently, futures markets are predicting a probability of over 80% for the Federal Reserve to cut rates by a cumulative 25 basis points in March 2024, with a total rate cut of over 150 basis points by the end of the year. In terms of asset classes, equities in Europe and the United States performed well, outperforming bonds. Investment-grade bonds slightly outperformed high-yield bonds, and the overall returns of both stocks and bonds experienced a slight decline compared to November. 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	4.25	-43	-18	3.55	5.26
5Y	3.85	-42	-16	3.20	4.99
7Y	3.88	-46	-8	3.24	5.03
10Y	3.88	-45	0	3.25	5.02
30Y	4.03	-47	7	3.49	5.18

China	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
3Y	2.29	-18	-13	2.18	2.57
5Y	2.39	-18	-23	2.34	2.75
7Y	2.54	-14	-28	2.51	2.89
10Y	2.56	-13	-28	2.54	2.94
30Y	2.83	-11	-37	2.81	3.32

Japan	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	0.05	2	1	-0.09	0.18
5Y	0.21	-5	-3	0.05	0.49
7Y	0.36	-7	-9	0.08	0.73
10Y	0.61	-6	19	0.18	0.97
30Y	1.63	-3	2	1.11	1.91

Germany	Last Price %	1M chg bp	YTD chg bps	52W low%	52W high%
2Y	2.40	-41	-36	2.10	3.38
5Y	1.95	-43	-63	1.86	2.93
7Y	1.94	-43	-63	1.83	2.94
10Y	2.02	-42	-55	1.89	3.03
30Y	2.26	-42	-28	1.93	3.26



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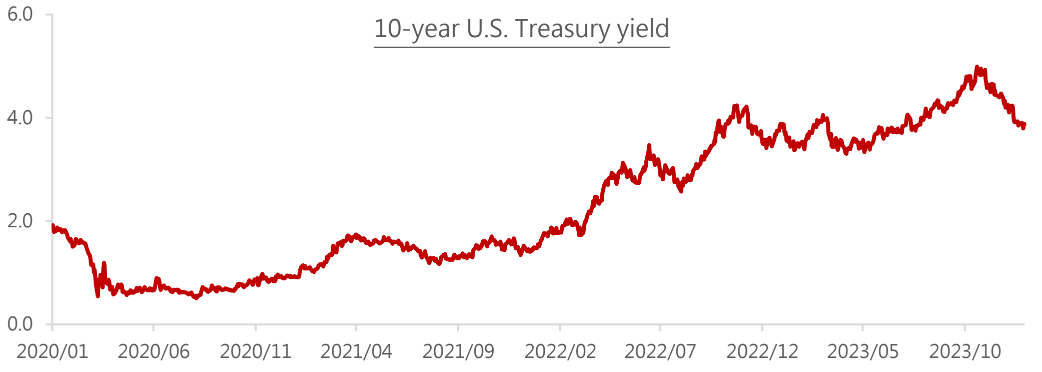


In December, US Treasury bond rates continued to fall from November. The main catalyst was the release of the Federal Reserve's dot plot in the FOMC meeting, which showed a substantial downward revision to the future rate path. The meeting minutes indicated that there was no need to wait for inflation to reach 2% before cutting rates, and discussions on rate cuts had already begun. Both before and after the Fed meeting, futures markets priced in a higher probability of rate cuts starting in March, and the expected cumulative rate cut by the end of 2024 increased from 100 basis points to 150 basis points. Market expectations for rate cuts currently exceed the projections of the dot plot by a significant margin.

Corporate bonds were impacted by the sharp decline in rates, and saw further tightening of spreads. This reflects the market's optimistic outlook on future economic trends and confidence in the Federal Reserve's ability to cut rates swiftly. In particular, Asian investment-grade bond spreads have tightened to nearly five-year lows, while investment-grade bond spreads in the US and China have narrowed to levels not seen in two years, with significant spread tightening observed in the financial sector.

Bank sector bonds, especially AT1 bonds, saw significant gains this month. In addition to the rate-related tailwinds, UBS and Banco Santander announced the full redemption of their respective subordinated perpetual bonds, boosting market sentiment. Yankee and US bank sector bond spreads also narrowed noticeably.

High-yield bond prices also rose notably, particularly in the US high-yield segment, with year-to-date price growth exceeding 10%. As benchmark rates decreased, the financing costs for high-yield issuers continued to decline. In December, the primary issuance of high-yield bonds was primarily focused on refinancing, with a relatively small proportion coming from additional financing needs.

The central bank maintained the one-year Medium-Term Lending Facility (MLF) rate at 2.5%, but increased the MLF by 800 billion yuan, exceeding expectations by 400 billion yuan, marking the highest monthly record. On December 8th, the Politburo held a meeting to analyze and study the economic work for 2024, aiming to coordinate the expansion of domestic demand and deepen supply-side structural reforms in order to consolidate and enhance the positive momentum of economic recovery. Economic data is still awaited for a rebound and further observation.

Onshore liquidity conditions remained stable overall, with the DR007 and R007 rates staying relatively steady around the policy rate of 1.8%, except for a slight increase in the final week. The 3-month Shibor rate showed an initial increase followed by a decline around the middle of the month. Onshore RMB interest rates exhibited a bullish trend throughout the month, and it is expected that monetary policy will exert influence at the beginning of the year. The market has expectations for reserve requirement cuts and interest rate reductions, while the pressure on fiscal issuance in January is not significant. Therefore, RMB yields, especially in the front and middle end of the curve, are still biased towards downward movement. On the technical side, the 10-year yield has support at 2.55% and the next support level is at 2.45%, while other tenors are also supported nearby.

The spot USDCNH exchange rate fluctuated in the range of 7.08-7.2, primarily driven by the dovish turn of the Federal Reserve, which weakened the US dollar, and end-of-year settlement flows. Offshore currency swaps were divided around the middle of the month, with an initial increase driven by onshore liquidity conditions followed by a decline. Apart from this, upward movements were mainly driven by the decline in US dollar yields, while upward movements were mainly driven by the decline in onshore RMB interest rates.

CDX Index	Current Value	1M chg bp	YTD chg bps	52W low%	52W high%
IG CDX	57	(6)	(25)	55	94
HY CDX	356	(46)	(128)	350	554
EM CDX	167	(20)	16	165	275
Bond index					
ICE Asian Dollar Corporate	445	2.7%	6.7%	416	445
ICE China Issuers Dollar IG Corporate	210	2.3%	6.8%	198	210
ICE China Issuers Dollar HY Corporate	153	0.8%	-20.5%	143	218
ICE US Corporate	3239	4.0%	8.4%	2929	3253
ICE US High Yield	1590	3.7%	13.4%	1418	1591
ICE Emerging Markets Corporate	433	3.3%	7.9%	401	433
Bloomberg Global-Aggregate	471	4.2%	5.7%	429	473
Bloomberg Global-Aggregate 1-3 Year	174	2.0%	4.3%	166	175

Economic Data

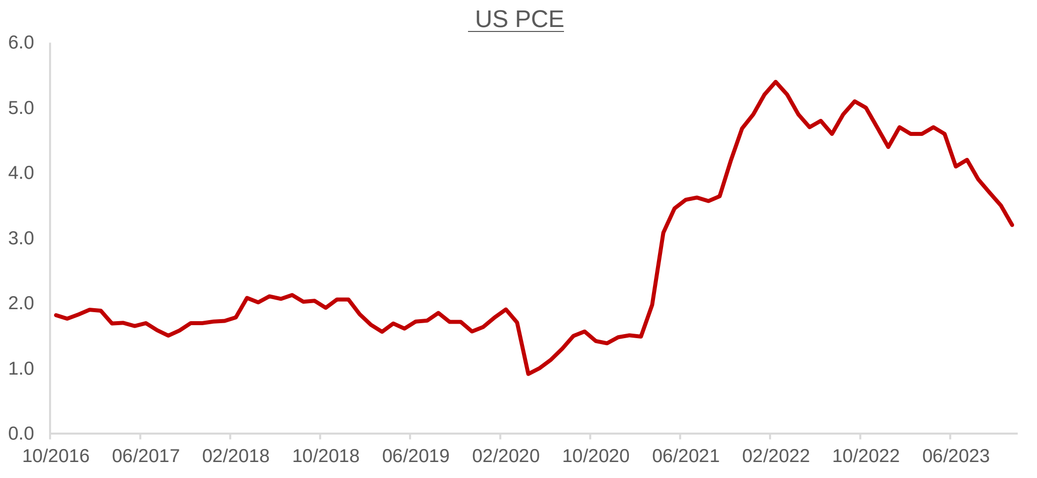
In December, overall US economic data remained relatively positive, showing no clear signs of recession. The US GDP growth for the third quarter was revised down to an annualized rate of 4.9%, still indicating strong growth for the quarter. In terms of employment, the unemployment rate slightly decreased compared to the previous month in November, and non-farm payroll employment exceeded expectations and the previous value, indicating that employment is currently maintaining a healthy state. The employment index in the ISM Non-Manufacturing PMI was better than the previous month, while the employment index in the Manufacturing PMI was weaker than the previous month, continuing the trend of stronger employment in the service sector compared to the manufacturing sector observed last month. Inflation-wise, inflation in November continued to slow compared to October, while personal income and spending growth continued to decelerate. The year-on-year growth rate of core PCE in November was 3.2%, with PCE declining by 0.1% on a monthly basis, marking the first decline since the rate cuts.

The December FOMC meeting kept the interest rate unchanged as expected, and the market interpreted this meeting as dovish. The latest dot plot shows a median target rate of 4.625% at the end of 2024, equivalent to a rate cut of 75 basis points, and a median target rate of 3.625% at the end of 2025, equivalent to a rate cut of 175 basis points. The dot plot from September had a median target rate of 5.125% at the end of 2024 and 3.875% at the end of 2025. The Fed acknowledged in its statements that inflation pressure in the United States has weakened but remains elevated, and economic growth has slowed, leading to discussions of rate cuts. The European Central Bank (ECB) and the Bank of Japan (BOJ) also kept their benchmark interest rates unchanged. In Europe, the high rates have had an impact, with both core CPI growth slowing on a year-on-year basis and experiencing negative growth on a monthly basis. The Eurozone's GDP growth for the third quarter was -0.1% on a quarterly basis, indicating a contraction, with no growth on a year-on-year basis. Japan's GDP growth for the third quarter was -0.7% on a quarterly basis, and the CPI growth rate has slipped from its peak, leading to ongoing market attention on Japan's intention to phase out its loose monetary policy.

Outlook

Overall, we maintain a neutral view on the US economy for 2024. Economic growth is expected to moderate but should avoid a severe recession barring any black swan events. The pace of credit contraction is a key indicator to monitor, and there are two risk points to be cautious of. The first is geopolitical conflicts, such as the escalation of the Israeli-Palestinian conflict or intensified trade and technology sanctions between major economies. The second is the continuation of robust employment leading to increased real income or a resurgence in housing prices, which could trigger inflationary risks. The significant decline in US Treasury yields in November and December resulted in crowded market trades and divergent views on duration among investors. The future direction of US Treasury yields requires more definitive economic data or signals from the Federal Reserve. Investors lack strong confidence in the rapid decline in short-term interest rates, and subsequent rate fluctuations may occur as economic data improves or Fed officials' forward guidance change. Currently, we remain cautious on duration, and stay alert to the potential reversal of the extremely optimistic trading logic seen in the market over the past two months, which could lead to asset price corrections.

Currently, US investment-grade credit spreads have tightened to historical lows. In December, market sentiment was optimistic, with major stock indices rising and per-share indicators entering oversold territory. Investment-grade bond spreads are at relatively expensive valuation levels. Considering the increased supply of bonds in January, the odds and success rates of betting on further credit spread compression seem low. Short-term adjustments in sentiment may lead to widening spreads between across credit ratings and widening spreads in longer tenors. Asian US dollar bonds can serve as a relatively safe haven and risk diversification asset. In the Chinese investment-grade bond market, due to relative supply shortage, investment-grade bonds with high credit ratings have reached historically low spreads, and long-dated spreads have tightened significantly. We will continue to observe the issuance situation and expect spreads to remain at low levels with some fluctuations. Short-term bonds should be added opportunistically following interest rate movements. In the Chinese high-yield sector, prices have risen recently due to improved domestic sentiment, but there has been no fundamental or policy reversal. Future price changes will be more closely related to domestic market sentiment. It is important to monitor the financial conditions of individual companies and maintain caution. In summary, for Asian investment-grade bonds, as long as the Federal Reserve does not provide clear signals of rate cuts, spreads are likely to fluctuate mainly in response to increased supply. It is not ruled out that spreads may widen. Investors could also consider countries with relatively more room for spreads, such as Australian bank sectors. Once Japan exits its accommodative policy, Japanese credit spreads are also expected to tighten. High-yield bonds may continue to see further increases in the future, but differentiation will occur among sectors and companies. It is advisable to select countries and sectors with strong economic growth.



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