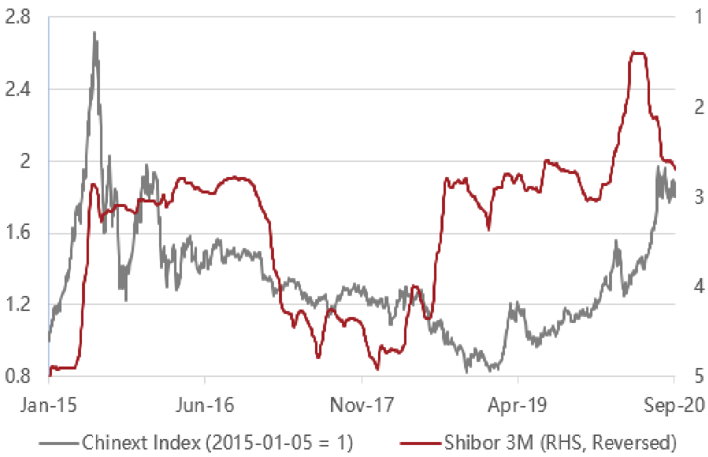
China Bulletin: Market View



Equity Market

China A shares have dropped around 5% since our last report, and we may see a structural market ahead instead of a universal rally. Lagging by around 2 months, the tightening monetary conditions finally passed through to the equity market. Especially to the Chinext and STAR market, which are both filled with tech names and healthcare start-ups. Tech and healthcare companies benefitted from the substantial liquidity that has been injected to support financial markets against the pandemic and now may fall after PBoC has begun tightening liquidity. Economic data continues to improve and valuations for some sectors stand below their historical average, which points to outperformance of undervalued blue-chip stocks with lower volatility, among which commercial banks, utilities and transportation are top picks to us.

External uncertainty has remained elevated in the last fortnight, notably from the persistent tension with the US and the border standoff with India. The potential cut-off of microchip supplies to Huawei remains a risk, and the forced sale of TikTok adds to the already stretched tension with the US. We reiterate the view that before the US presidential election, more and more headline events will show up, but the impact should be under control as long as the Phase 1 trade deal is intact. The standoff along the border with India could date back to half a century ago, and the window for any military operation is about to close in a couple of weeks due to the weather. Thus, any escalation to armed conflict between China and India is not an acute risk at the moment.

Economic Policy

PBoC policy normalization is coming to an end for the time being and the market has adjusted to the new stance as well. Money market and government bond rates are stabilizing around the 2019-end, pre-pandemic level, after a swift rise. Policy makers deployed various policies to support companies that were hit by the pandemic, and as a result credit risk may be less serious than previous downturns. Although a lower rate is not expected, China onshore bonds stand out in a globally low rate environment and offer attractive risk adjusted rewards.

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