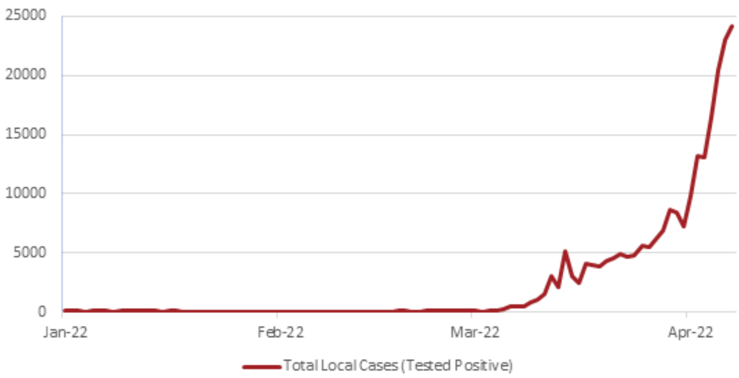
China Bulletin: Market View



The spread of the highly infectious omicron variant is hitting China's economy on the largest scale since the initial outbreak in 2020, as Shanghai is locked down after reporting an unprecedented number of cases. Judging from the current available information, the impact may last into May, instead of being confined within 22Q1 per our previous forecast. This adds to the headwinds against China's growth target for 2022 and underlines the necessity for fiscal policy to step up support for the economy. Such support was traditionally in the form of spending on infrastructure investment but is now diversified across several fields such as affordable housing construction, renewable energy capacity & grid investment, and building data centers in addition to infrastructure investment, making tracking the process more difficult than before. Therefore, it is prudent to monitor this on an ongoing basis and we will continue to provide updates.

The latest economic data offers little comfort despite January-February growth data beating market expectations. The fact that, historically, manufacturing fixed asset investment in the first two months of a given year only makes up about 5% of that year's total, weakens the recovery signal. Especially when the most recent service sector PMI registers the second lowest reading in decades. The housing market continues to slide amid a wave of policy loosening, though policy makers have still refrained from loosening their grip on core cities until now, and some measures deemed too aggressive have been revoked shortly after being announced. We reiterate our opinion that the heavy debt burden and sluggish income growth facing the household sector are the most worrisome problems, and the common prosperity policy may be the most suitable solution.

Coming out of the liquidity crunch in mid-March, equity market sentiment is still fragile, while bond markets are more positive. The equity market is still seeing elevated volatility in recent weeks, leading to the low volatility strategy's considerable outperformance. Based on the still sluggish growth momentum and accommodative policy, we expect low volatility to outperform until end Q2, when growth momentum may pick up meaningfully. Bond markets, on the other hand, are less attractive since current levels have largely priced in the growth outlook and accommodative monetary expectations.

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