China Bulletin: Market View

China's equity market has stumbled at the beginning of 2022 and growth investing has taken the most severe hit, along with its global peers. Semiconductor and new energy supply chain names, as representatives of growth investing and free of policy headwinds, have borne the brunt initially. The drawdown should be temporary for Chinese growth stocks; domestic monetary policy is positioned to a more accommodative stance in light of the economic downturn. However, the domestic and external uncertainty will add to the volatility of the Chinese equity market.

The size factor was the key one in 2021 where the CSI 500 Index outperformed the Shanghai Shenzhen 300 Index(composed of the largest 300 companies) by 21.1% with similar volatility, benefiting from the shift of monetary policy in July. However, we attach more significance to the low volatility factor in 2022, as uncertainty is mounting due to several significant political events, in addition to the combination of sluggish growth in China and persistent inflation in the US.

Traditionally, it is very difficult to assess the growth momentum of China at the beginning of a year, but various indicators show that the slowdown is continuing. The absence of economic data and the calendar effect introduced by Chinese New Year make the first two months of the year less measurable and less important regarding growth. PMI data shows domestic confidence remains subdued, while export data points to more resilient external demand. Inflation data surprisingly undershoots expectations and CPI prints a much lower reading than the policy target. Though PPI remains elevated due to the shock of the energy price hike, the mediocre consumer inflation increases the possibility of PBoC moves to cut the policy rate. The housing sector remains the economy's most meaningful swing factor - and continues its downturn. The relative strength of fiscal support against the housing sector downturn, and the fading export momentum, are the key factors to watch for China's economic growth in 2022.

In fixed interest, the Chinese bond market keeps compressing credit and term spreads to extremely low levels, in the hope of a policy rate cut in the near future. In our view, the Chinese bond market offers quite unattractive risk-reward currently, but acts as a gauge for the financial markets' condition. A substantial jump of rates may hint the end or at least the pause of the size factor's outperformance.

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