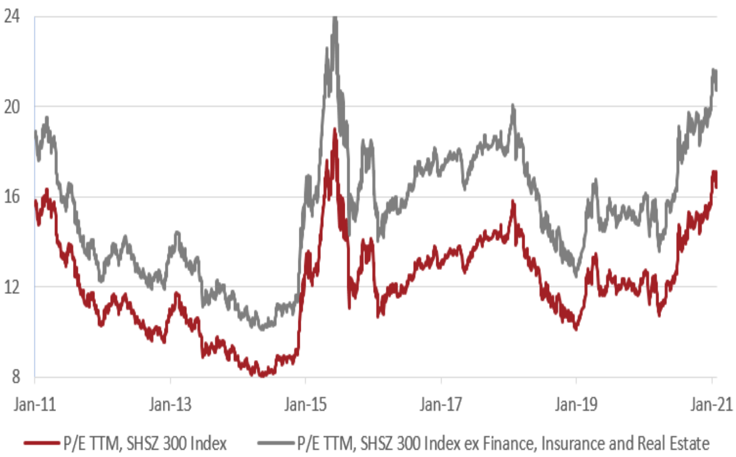
China Bulletin: Market View



The market remained optimistic about Chinese equities going into 2021, until recently when there has been a marginal weakening of sentiment. Large caps rallied quite strongly, bringing the Shanghai Shenzhen 300 Index, consisting of the largest 300 listed companies in the Chinese market, close to its all-time high, previously reached in 2007. Though suffering from distortion due to the Covid-19 pandemic, the valuation indicator, P/E TTM (Trailing Twelve Months), still seems a little expensive to us assuming a growth rate of 20% for 2021. In our view, growth, as well as earnings, will remain upbeat in the coming quarters, yet the monetary policy of the PBoC will not be as supportive as before, which could increase market volatility. The combination of buoyant growth expectations and gradually tightening monetary policy suggest a low volatility portfolio of China A shares for 21Q1.

Sector wise, the market still prefers internet, healthcare, solar energy, consumer staples, and commercial banks. The ambitious environmental policy targets across the globe are boosting sentiment towards solar energy, while the electronic vehicle supply chain performance has been less impressive recently. Commercial banks will actually benefit from a tighter monetary environment and are still undervalued even after taking into consideration the concerns over their asset quality. We believe that we will not see large scale SOE defaults and that the recent local SOE defaults are idiosyncratic rather than systematic risks. On the other hand, more write-offs of bad assets mean a better earnings outlook in the future.

In the Money Market we saw sudden tightening from mid-January, and the repo rate spiked to its highest level in the last 5 years. The move does not mark a change of monetary policy pace but rather is a reminder to the market that the expectation of monetary policy to remain accommodative is not what the PBoC wants to see. Rates traded higher accordingly, erasing the gain in recent weeks, and we remain neutral on the Chinese bond market in the short term before Chinese New Year and perhaps in 21Q1.

The Central government has emphasized to local authorities the requirement to honour capital market rules, reducing the possibility of further willful default, which was the concern behind the bond market tumble towards the end of 2020. After three years of crackdowns on shadow banking, the debt problem is more controllable and less contagious than before. Though we may not see a quick solution to the problem, the likelihood of future credit squeezes has decreased since the recent bond market turmoil.

2nd Floor | 75 King William Street
London EC4N 7BE
+44 203 617 5260
marketaccess@chinapostglobal.co.uk
www.chinapostglobal.com

2nd Floor | 75 King William Street
London EC4N 7BE

+44 203 617 5260

marketaccess@chinapostglobal.co.uk

www.chinapostglobal.com

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