Whatever it takes, China

11 April 2022

by Lorenzo La Posta, CFA

This is not the first time I have written about Chinese equities and loyal readers will remember last August[1], when the media were calling it an "uninvestable" market, we were finding pockets of value and interesting opportunities. This year, a new wind is blowing under the Red Dragon's wings.

But let's rewind the tape and press play on February 2021. Valentine's Day had just gone, the stock market was at a peak, but no one knew what was coming. Chinese regulators tightened regulation around privacy and data protection, specifically targeting the hugely successful internet sector. Widely held stocks, such as Alibaba, Tencent and Meituan, started falling as markets marked down their growth expectations. The private education sector was made not-for-profit almost overnight and the main players such as TAL Education and New Oriental Education were wiped out. The real estate sector's excessive leverage was brought down through the "three red lines" regulatory guidelines, introduced in August 2020, aimed at making the sector less appealing for speculators and more stable for the population. As a result, one of the largest developers, Evergrande, moved toward default. All these actions were taken in the name of "common prosperity"; a political objective aimed at making sure China grows in a sustainable and socially responsible way, but global markets saw that as an attack to the private sector and a negative for the country's growth potential.

Now fast forward to the middle of March 2022 - the market was down more than 50%[2] from its peak and the People's Bank of China (PBOC) stepped in to avert this trend. It's not quite a "whatever it takes" moment[3], but certainly the central bank has loaded the big guns.

In a press conference in January, the PBOC had already stated that "after a few months, the downward pressure on the economy will become yesterday's story"[4].

The decline in the macro-leverage in the past five quarters has created room for a more proactive and front-loaded monetary policy and signals are that corporate lending rates are likely to be cut, following the December cut in the medium-term lending facility, and that a reduction in banks' reserve ratio requirements (RRR) could also be in play. The central bank is guiding markets towards a cautious stance on the Chinese Yuan and is willing to keep fighting excessive appreciation.

At the Financial Stability Committee special meeting in mid-March, a few more practical points were laid out[5]. Credit growth was again a priority; the transition to the new model for the housing sector outlined by the "three red lines" is to be smoothed; big technology names will face a more transparent and predictable regulatory environment; Beijing is to work with Hong Kong to stabilise the local market; economic and monetary policies will coordinate to prioritise financial stability; American Depositary Receipts (ADRs) are going to be audited jointly by China and the US; a balance is being struck between Covid-19 containment and economic growth.

Markets have got what they were hoping for. At the time of writing, Chinese equities are up more than 20%[6] from their lows and this could prove to be the inflection point. But there are some lingering questions. Is China going to try to take over Taiwan? Are the trade wars with the US going to escalate further? Is the PBOC going to change its mind and not go through with this accommodative policy? We warrant caution, as always, but we have been constructive on China for a while now, partly because of the cheaper valuation of local assets and partly because of the undeniable attractiveness of a deep equity market with the added tailwind of a more accommodative monetary policy.

[1]Momentum Global Matters, "Experts' view on China", 23 August 2021. [2&6] Source: Bloomberg Finance L.P., MSCI China Index. [3]Former European Central Bank President Mario Draghi, 26 July 2012. [4]Source: 1167 Capital, Morgan Stanley Research, "NPC: Unequivocal Reassurance on Growth", 06 March 2022. [5]Source: 1167 Capital.

Market Focus

- **Global equities fell -1.4% last week**
- **President Macron is set to face far-right rival Marine Le Pen in the second and final stage of the French presidential election in two weeks' time**
- **Brent crude fell -1.5% over the week to $102.8 a barrel**
- **Gold returned +1.1% to $1947.5 per ounce**

US

- US equities fell -1.2% last week.
- The composite PMI for March was revised down to 57.7 from its flash reading of 58.5.
- The ISM services index came in slightly below expectations at 58.3 vs 58.5 expected. It of course remains firmly in expansionary territory above 50.
- Weekly initial jobless claims for the week ending 2nd April fell to their lowest level since 1968 with just 166k initial claims.
- Factory orders for February showed a -0.5% contraction (vs -0.6% expected).
- Final reading for durable goods orders in February showed a -2.1% decline (vs -2.2% preliminary reading).
- Minutes of the March Federal Open Market Committee (FOMC) meeting were released where it was indicated that a 50bps rate hike would have happened in March had Russia not invaded Ukraine, policymakers are now ready to entertain a 50bps rate hike going forward.

Europe

- European equities returned +0.1% last week
- The composite PMI for the Euro Area came in at 54.9, revised upward from its flash reading of 54.5.
- Euro Area PPI for February came in at 31.4% year-on-year vs 31.6% expected, the fastest pace since the formation of the single currency.
- German factory orders contracted by a larger than expected -2.2% in February (vs -0.3% expected).
- Euro Area retail sales grew by 0.3% in February vs 0.5% expected.
- German industrial production grew by 0.2% in February, in line with expectations.
- Euro Zone flash CPI came in at a fresh record high of 7.5%, its highest since the formation of the single currency and up from 5.9% in February.

Rest of the World/Asia

- The benchmark Global Emerging Markets index returned -1.5% last week.
- Japanese equities fell -2.4% over the week. Further easings of border restrictions failed to counteract weakening investor sentiment from an increasingly hawkish Fed and the financial ramifications of the war between Russia and Ukraine.
- Chinese equities returned -1.6% last week.
- The Reserve Bank of Australia kept policy rates on hold but highlighted that they would be "patient" in evaluating the outlook, opening the door to rate hikes in the coming months.
- Japanese household spending rose by 1.1% year-on-year in February, below market expectations of 2.7%
- The Chinese Caixin services PMI dropped to 42.0, its lowest level since February 2020 and beneath the 49.7 expected as localised lockdowns take hold.
- China's PPI for March came in at 8.3% year-on-year, whilst CPI was up 1.5% year-on-year.
- Japan's current account swung back to surplus in February to 1.6trn yen following a -1.2trn yen deficit in January – the second largest deficit on record.

UK

- UK equities returned +2.1% last week.
- The composite PMI for March came in at 60.9 vs its flash reading of 59.7.
- Industrial production grew by 0.6% in February vs 0.3% expected whereas manufacturing production fell by -0.4% vs 0.4% expected.

Past performance is not indicative of future returns. Source: Bloomberg Finance L.P., returns in local currency unless otherwise stated.

Market Summary

Asset Class / Region	Currency	Cumulative returns Week ending 08 April	Month to date	YTD 2022	12 months
Developed Markets Equities					
United States	USD	-1.2%	-2.5%	-5.8%	10.6%
United Kingdom	GBP	2.1%	1.7%	7.1%	17.9%
Continental Europe	EUR	0.1%	-0.4%	-7.5%	5.2%
Japan	JPY	-2.4%	-3.6%	-3.7%	-0.5%
Asia Pacific (ex Japan)	USD	-1.4%	-2.0%	-6.3%	-13.9%
Australia	AUD	-0.2%	-0.5%	1.0%	11.2%
Global	USD	-1.4%	-2.7%	-6.5%	5.5%
Emerging Markets Equities					
Emerging Europe	USD	-2.7%	-3.6%	-71.6%	-67.6%
Emerging Asia	USD	-1.6%	-2.1%	-9.1%	-18.1%
Emerging Latin America	USD	-3.8%	-1.8%	24.6%	17.3%
BRICs	USD	-1.1%	-1.0%	-12.0%	-24.0%
China	USD	-1.6%	-2.5%	-13.1%	-34.2%
MENA countries	USD	1.9%	2.0%	16.1%	33.5%
South Africa	USD	-2.0%	-2.9%	18.3%	7.2%
India	USD	0.7%	1.5%	1.6%	18.8%
Global emerging markets	USD	-1.5%	-1.8%	-7.4%	-14.2%
Bonds					
US Treasuries	USD	-1.7%	-1.9%	-7.0%	-5.7%
US Treasuries (inflation protected)	USD	-1.4%	-2.1%	-5.1%	2.3%
US Corporate (investment grade)	USD	-2.4%	-2.4%	-9.8%	-7.4%
US High Yield	USD	-1.3%	-1.4%	-6.2%	-2.9%
UK Gilts	GBP	-1.6%	-1.0%	-8.5%	-7.6%
UK Corporate (investment grade)	GBP	-1.0%	-0.6%	-7.4%	-6.9%
Euro Government Bonds	EUR	-1.3%	-1.1%	-6.9%	-8.1%
Euro Corporate (investment grade)	EUR	-0.7%	-0.3%	-5.7%	-6.4%
Euro High Yield	EUR	-0.5%	-0.3%	-4.6%	-3.4%
Japanese Government	JPY	-0.2%	0.1%	-1.9%	-1.7%
Australian Government	AUD	-0.8%	-0.9%	-7.4%	-7.0%
Global Government Bonds	USD	-2.0%	-2.3%	-8.5%	-10.3%
Global Bonds	USD	-2.7%	-2.4%	-8.9%	-10.6%
Global Convertible Bonds	USD	-1.8%	-2.2%	-9.1%	-13.5%
Emerging Market Bonds	USD	-2.3%	-5.2%	-18.4%	-16.8%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

Market Summary

		Cumulative returns			
Asset Class / Region	**Currency**	**Week ending 08 April**	**Month to date**	**YTD 2022**	**12 months**
Property					
US Property Securities	USD	-1.2%	-0.6%	-3.4%	23.1%
Australian Property Securities	AUD	-0.7%	-1.1%	-9.6%	10.6%
Asia Property Securities	USD	-0.1%	-0.3%	0.3%	-10.1%
Global Property Securities	USD	-1.1%	-1.1%	-3.3%	9.9%
Currencies					
Euro	USD	-1.5%	-2.6%	-3.9%	-8.8%
UK Pound Sterling	USD	-0.6%	-0.9%	-3.4%	-5.2%
Japanese Yen	USD	-1.5%	-2.0%	-7.4%	-12.2%
Australian Dollar	USD	-0.4%	-0.7%	2.9%	-2.5%
South African Rand	USD	0.3%	-1.0%	9.0%	-0.9%
Swiss Franc	USD	-0.8%	-1.2%	-2.0%	-1.1%
Chinese Yuan	USD	0.0%	-0.3%	0.1%	2.9%
Commodities & Alternatives					
Commodities	USD	1.5%	-1.2%	27.5%	61.2%
Agricultural Commodities	USD	3.3%	1.5%	19.8%	48.9%
Oil	USD	-1.5%	-9.4%	29.6%	62.6%
Gold	USD	1.1%	0.8%	7.4%	10.8%
Hedge funds	USD	-0.1%	0.0%	-1.3%	0.1%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

For more information, please contact:

Distribution Services

E: distributionservices@momentum.co.uk

T: +44 (0)207 618 1806