# Market Snapshot (29th November, 2021)

## Short-term Market Conditions Volatile Due to National Policy Risks

Chinese equity markets were somewhat volatile in the third quarter. Various factors slowed China's economic activities, such as regulatory interventions in the internet and education sectors, supply chain bottlenecks, and floods in the Henan province. Recently released economic data – including China's manufacturing purchasing managers' index, the industrial production index, and fixed asset investment – fell below expectations, hovering around critical levels. The People's Bank of China ("PBOC") took active measures to boost the economy, such as reducing the reserve requirement ratio in July, to increase liquidity and stimulate corporate borrowing.

Meanwhile, the Hong Kong stock market reacted negatively to China's policy risks and the domestic housing debt crisis, with a number of sectors being oversold in August. The market rebounded slightly at the end of September, but there was still a decline of more than 20% compared to the February high. Given uncertainties surrounding policies and regulations, the Hong Kong investment atmosphere has not changed significantly.

## Details of China's Policy yet to be Confirmed, Further Reduction to Reserve Requirement Ratio Expected

Owing to steady vaccination progress in developed countries, the world's major economies are expected to continue on their paths to recovery in the fourth quarter of this year. Thus, market focus will turn to the rebound of economic growth, the impact of inflation, specific details of central banks' reductions in bond-buying, and decision on changes in interest rates.

We believe it is highly likely inflation will soar temporarily. However, if markets continue to see high inflation rates going into the fourth quarter or the first half of next year, the U.S. Federal Reserve ("Fed") is expected to adopt a more hawkish stance, increasing downside risks in the stock market.

Confronted with an economic slowdown, we expect China's central government to further reduce the reserve requirement ratio in the fourth quarter. During its recent meeting, the Central Financial and Economic Affairs Commission said a key policy is supporting income equality. The new policy will provide more public expenditure and offer a level playing field to people with less in-demand skills and lower education and income levels, while simultaneously promoting and expanding the consumer economy.

In Hong Kong equity markets, investor uncertainties have not faded despite the Chinese government offering clarification on recent regulatory changes and its economic aspirations. Officials are expected to announce further details regarding the "common prosperity" agenda and launch the corresponding policies.

Although China's dependence on exports has decreased in recent years, exports are still an important component of economic growth. China is therefore concerned about global transportation logistics and supply chain congestion. If transport costs do not subside, rising export costs could affect enterprise profits. Furthermore, recent restrictions on power consumption in some provinces have led to reduced production and even factory shutdowns. A failure to meet shipment schedules will weigh on the prospects of the manufacturing and export industries next quarter.

## Sustained Economic Growth in Asia Led by Policy Support And A Rising Demand for Technological Hardware

Although Southeast Asia is still grappling with a rebound in COVID-19 cases, previous Sino-US trade disputes led many U.S. enterprises to seek suppliers in other Asian countries. Vietnam has benefited, seeing inflows of foreign capital and a growth in factory numbers. The Vietnamese government has also reduced taxes on corporate profits and has even offered early stage tax-free concessions to select large-scale investment enterprises. Bank Indonesia, meanwhile, has left target interest rates unchanged at an historic low of 3.5% for the remainder of the year, with accommodative monetary policies in place to facilitate corporate loans. Indonesia's GDP growth in 2021 is expected to fall between 4.1% and 5.1%. Unlike other emerging nations which have begun hiking interest rates, Indonesia does not appear to be facing inflationary pressures.

The Bank of Korea announced an interest rate hike of 0.25% in August, predominantly driven by strong market sales and exports. As of July, exports of automobiles and automotive chips had maintained growth for nine consecutive months, reaching a cumulative export volume of USD358.7 billion. The record high suggests there is still considerable room for growth in South Korean exports in the medium and long term.

Global supply of chips remains tight. Taiwanese chip manufacturers specialising in advanced chip technology will reportedly raise foundry prices in the fourth quarter. If U.S. dollar trends do not change significantly, it may help attract capital flows into the Asian market.

## Capital Could Move from U.S. to Asian Markets Given Attractive Valuations And Supportive National Policies

The Fed's announcement following the recent Federal Open Market Committee ("FOMC") meeting suggested an acceleration of interest rate hikes, falling in line with market expectations. Investors, however, should note that the U.S. stock market has been running high for some time and September is historically a weak period for U.S. equities. The market has the opportunity to lock in high profits, creating a more cautious investment environment.

Against the background of ongoing vaccination programmes, Asia and China are expected to witness stronger consumption growth in the final quarter of 2021. Our investment strategy will balance growth and cyclical/recovery stocks to more effectively manage macroeconomic risks. We will also increase our long-term holdings in enterprises with high cash reserves and strong fundamentals.

## Promising Industries in Chinese And Asian Stock Markets

Although China's stock market is battling volatility, many sectors exhibit growth potential. We will assess valuations and national policies when considering potential long-term investments. Among them, we remain optimistic about new energy vehicle batteries, the manufacture of battery-related raw materials, and businesses supported by national policies. In view of the global trend in reducing carbon emissions, new energy usage will increase significantly. The industry has structural growth potential due to the development of relevant domestic technologies and the optimisation of power supply equipment.

Additionally, the "national tide" trend saw more young people in China and the general public support local brands and boost consumer shares, particularly in sporting goods and clothing. China's "national exercise" initiative encourages citizens to focus on their personal health and lifestyle, further benefiting local sports brands as well as dairy-related products. Meanwhile, the "common prosperity" initiative could improve the economic standing of low and middle-income people in the medium and long term, thus introducing a new customer base for retail and sales industries and creating business opportunities.

Furthermore, although augmented/virtual reality ("AR/VR") securities are not new to the market, the industry is experiencing technological breakthroughs. We anticipate these will create a new wave of demand for AR/VR-related products, which is worthy of investors' attention.

The pandemic has significantly boosted demand for logistics services in Asia, but insufficient port capacity and excess demand has increased freight rates, driving up profits in the shipping industry. We will therefore continue to hold shipping stocks. Since many Asian countries implemented accommodative monetary policies to rescue markets last year, inflation has returned. We have increased our holdings of inflationary plays, including financial and commodity securities, to improve portfolio returns.

## Inflation Surges Higher But Long-term U.S. Bond Rates Remain Stable in the Third Quarter

The trend in long-term U.S. Treasury yields gradually stabilized in the third quarter, with 10-year rates hovering between 1.12% and 1.54%. The global bond market took a breather as tapering anxieties resulted in increased sensitivity to the remarks of central bank officials. Markets spent much of the quarter anticipating an announcement by the Fed regarding a reduction in its balance sheet, with tapering expected to begin in either the fourth quarter this year or the first quarter of 2022.

## PBOC Injects Capital to Stabilise Market Liquidity

While the United States was considering tapering asset purchases in the third quarter, China's market faced volatility due to slowing economic performance, policy risks, and the domestic housing debt crisis. In July, the government lowered the reserve requirement ratio to increase market liquidity and support economic recovery. However, the bond market remains weak due to the default risk of large domestic housing developers. Most local housing bonds and bond prices of related listed companies are under pressure.

Meanwhile, on 24th September, 2021, the Hong Kong Monetary Authority and the PBOC officially launched the southbound leg of Bond Connect, which will provide a more convenient and secure channel for mainland institutional investors. The link connects financial service institutions in Mainland China and Hong Kong, facilitating investments in Hong Kong and even international bond markets. The launch of Southbound Bond Connect may help ease the investment atmosphere of the mainland bond market in the short and medium term, while also supporting the sustainable development of Hong Kong's bond market and attracting a wider range of investors in the long term.

## Asian Central Banks Maintain Accommodative Monetary Policies

Apart from the Bank of Korea which announced an interest rate hike of 0.25% in August, other Asian nations are set to maintain highly accommodative monetary policies. Thus, the policy risk of interest rate increases is lower than in other regions and Asia's interest rate trend is also relatively stable compared to other developed economies. At present, the forecast default rate for Asian credit is 3% to 4%, while that of Chinese high-yield bonds is around 2% to 3%, with manageable overall risk. There is abundant liquidity in Asia, and the yield spread of investment grade bonds relative to the United States and Europe remains at an attractive 40 to 50 bps, so the return prospects of Asian investment grade bonds are still high. Looking forward in a growing-inflation environment, investors' risk appetite will likely improve. We believe capital will continue to flow into Asian investments looking for anti-inflation investments, which is conducive to the development of the region's bond market.