Market Snapshot (28th February, 2022)

Rate Hikes Ready to be Deployed to Combat Inflation

The U.S. economy is recovering: personal consumption expenditure ("PCE") rose in November last year, with core PCE climbing 4.7% over the year, and the unemployment rate has declined. Meanwhile, Chairman of the Federal Reserve ("Fed") Jerome Powell has also become more hawkish regarding rate hikes and is expected to maintain that view for at least the first half of 2022. In November, the United States decided to reduce its debt purchases by USD 15 billion per month, thus the pace of liquidity tightening will accelerate. Local inflation rose to 6.8% in November, a near 40-year high. BEA Union believes inflation will become a long-term trend this year. Amid an inflationary environment, we expect the Fed will gradually raise interest rates three times this year, exerting upward pressure on the US dollar. The US dollar index increased by 5.9% last year and is expected to continue its upward trajectory. Some major central banks are eager to take the lead in tightening monetary policy. In the fourth quarter of last year alone, the Reserve Bank of New Zealand raised interest rates twice while Bank of England's Governor Andrew Bailey surprised markets when he announced a rate hike of 0.15% owing to tight labour markets and inflationary pressures. Although some central banks are accelerating liquidity tightening, there is still ample capital circulating in markets which is believed to be sufficient to offset market volatility and reduce the likelihood of a sharp market downturn.

The pandemic severely disrupted global production and supply chains. Together with widening imbalances between supply and demand, rising labour and transport costs have driven up prices and sent inflation soaring. Floods of capital have been released over the last two years to prop up markets, but supply chain issues cannot be resolved in the short term. Further, prices of resources such as crude oil and coal have risen over the last year. The upward pressure on prices is not expected to dissipate before the end of 2022. Meanwhile, the United States could potentially lower import tariffs to ease price pressures. The news could see investors lock in profits at high levels and look for opportunities in other markets with more attractive valuations, such as in Asia. Investors should prepare accordingly.

Asian Stocks And Bonds Diverge And Require Different Strategies

BEA Union maintains a positive view on Asian markets, with India and Australia holding a slight edge. In terms of overall strategy, we are slightly overweight on stocks and remain cautious on bonds. When economic developments and policies become clearer, overall allocations in previously underperforming markets may gradually increase. The low price-to-earnings ratios of Asian stock markets have always attracted attention for their potential, while cyclical sectors and volatile regions offer investment potential. It is worth paying attention to the structural growth of the electric vehicle supply chain, Australian commodities, Indian steel, and solar energy and hydrogen supply chains.

The relative resilience of the Australian stock market, coupled with the maturity of its financial system, has created opportunities for mergers and acquisitions. Opportunities in the ASEAN market cannot be ignored. Among them, the Indian government is promoting the development of digitalisation across the country, e-commerce has facilitated online shopping, and the pandemic has promoted online consumption which has further developed local e-commerce. Global warming has led many countries to pursue carbon reduction, benefiting many of India's renewable energy companies. In addition, the Indonesian real estate industry has successfully shifted from high end to mass market, thus greatly improving its coverage. Contract sales are expected to continue increasing and optimise the industry's fundamentals. In addition, many Asian countries have emerged from the pandemic and economic activities are gradually returning to normal. However, supply has lagged for some time. The imbalance between supply and demand has driven up energy and material prices. Indonesia's oil and gas sectors will continue to benefit.

Mainland China's Pandemic Approach And Regulatory Policies Are Target-oriented

As for Mainland China, the outbreak has been largely contained under near-total lockdown conditions, but economic growth is under pressure. Looking back at the mainland's stock market in 2021, performance in the first half of the year was solid. Some sectors benefited from the pandemic, such as the technology industry, shipping, and exports. As for the second half of the year, performance was dragged down by the government's tightening of regulations on sectors such as real estate, the internet, and education, thus leading to slower development.

Last year, tighter measures were placed on excessive corporate borrowing which caused structural changes in fundamentals and reduced the risk of rapid market expansion leading to a bubble. Along with the "shared prosperity" national policy, the market still needs time to digest the changes. Short-term volatility is inevitable. Once the market consolidates or the government signals more accommodative policies, domestic housing credit conditions are expected to improve. BEA Union believes that when market uncertainties dissipate and sentiment improves, investors' resumption of interest in real estate will drive household appliances, automobile, and consumer markets, and future economic development will become more solid and stable.

Driven by the pandemic, we believe shipping, technology, and even virtual reality ("VR") and augmented reality ("AR") sectors will remain robust, while sectors such as electric vehicles and solar energy that are less sensitive to economic cycles will also benefit. The oversold stock market may provide long-term investment opportunities. Among them, the internet sector is valued at close to its annual low, while e-commerce and online advertising are expected to benefit from gradual economic recovery in the second half of 2022. In addition, in order to keep the labour market active, China lowered the loan prime rate ("LPR") by 5 basis points at the end of December, and further reductions are expected in the near future. The Mainland's zeroing attitude towards the pandemic, developments in industrial regulations and the implementation of policies have all played an important role.

Hong Kong Stocks Are Volatile And A Shares Have Growth Advantage

Performance of Chinese stocks in 2021

Stock market index*	Price	2021 performance (%)	P/E ratio
MSCI China A Index (USD)	82.7	-24.0	14.3
CSI 300	4,919.3	-6.6	17.9
Shanghai A-Share Index	3,789.5	3.2	15.5
Science and Technology Innovation Board 50 Index (STAR 50)	1,369.6	-3.7	81.0
Shenzhen A-Share Index	2,631.6	5.4	37.9
Growth Enterprise Market	3,328.6	8.1	61.6

Performance of Chinese bonds in 2021

China bond yield	Yield (%)	2021 change (bps)
10-year government bond	2.80	-37.8
10-year US interest rate spread	1.33	-91.5
USD Treasury#	3.45	41.7
5-year AAA-rated corporate bonds	3.31	-43.5

* Calculated in local currency unless otherwise indicated
# Source: JPMorgan Emerging Markets Bond Index Global Diversified, data as of 28th December, 2021
Source: Alpine Macro https://alpinemacro.com/emc/Dec29_2021/The_PBoC_Is_Still_Behind_The_Curve.pdf

Despite the strong performance of U.S. stocks in 2021, there were also significant capital inflows into A-shares and Hong Kong stocks. The chart above shows that A-shares outperformed their peers last year. While short-term market conditions remain volatile, long-term investors should look towards undervalued sectors based on the mainland's growth advantages. As more A-shares are added to the MSCI index in future, the trading volume of A-shares is expected to increase in the long term.

Regarding fundamentals, the future development of the A-share market is supported. And in terms of bottom-up selection, we are particularly optimistic about new energy, technology, and metaverse stocks.

In Hong Kong, Financial Secretary Paul Chan Mo-po expects economic growth of 6.4% in 2021, almost one percentage point higher than the February budget estimate. Despite recent uncertainties regarding customs clearance, Hong Kong's stock market was able to maintain its upward momentum as stable blue chips remained defensive, capital was plentiful, and corporate earnings growth was in line with market expectations. Low double-digit earnings growth is expected in 2022, and Hong Kong equities will be supported by liquidity-injecting policies in the mainland.

In terms of new geopolitical trends, it is likely Chinese firms will delist in the United States and move to Hong Kong. In addition to the introduction of a new listing model for special purpose acquisition companies, the Hong Kong stock market will attract more foreign capital, which is conducive to long-term development.

Investment Grade Bond Prospects

As for the bond market, Asian investment grade bonds have a shorter duration than those of the U.S. and other emerging markets. The shorter duration Asian investment grade bonds are less sensitive and have relatively stable prices. Furthermore, Asian investment grade bond yields are higher than those of global bonds, thus offering investors good risk-adjusted returns.

Investment grade bond yield comparison

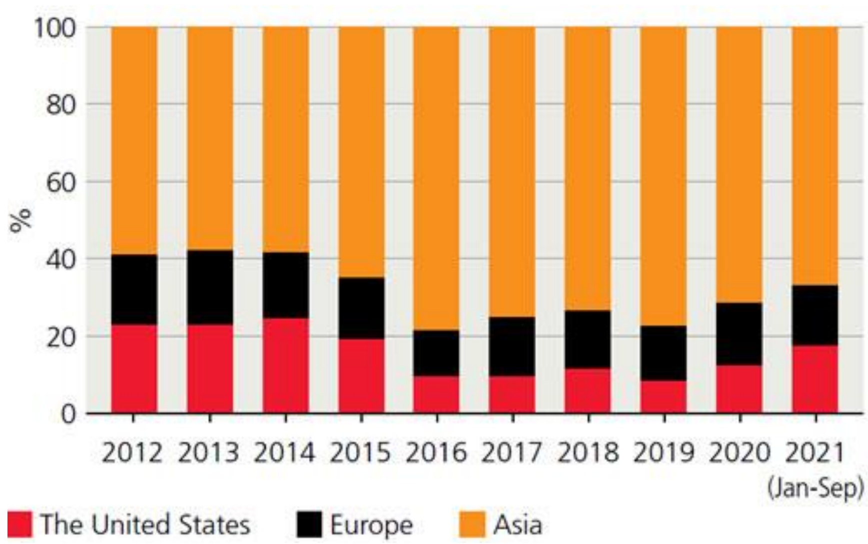
Investment grade bonds	Asia	Europe, Middle East, Africa	United States
Spread-to-worst (bps)	136	132	95
Modified duration to maturity	5.35	6.83	8.33

Source: Bloomberg, data as of 31st December, 2021

Other countries have the opportunity to tighten liquidity due to renewed inflation. Even though interest rates are still very low, rising rates benefit the banking and finance industries, especially banking systems with abundant capital and high liquidity. In the Asian region, bonds from Hong Kong, Singapore and South Korea have the potential to be among the top performers.

Meanwhile, credit indicators and ratings for investment grade debt across Asia are continuously improving. Emerging markets have potential given their large and loyal regional investor base.

Percentage of investment grade bonds issued by region



Source: JPMorgan Chase, data as of September, 2021

Generally, Asian investment grade debt is more stable than high-yield bonds and is less exposed to China's trade, leasing, and technology, media and telecommunications ("TMT") sectors. Therefore, BEA Union is confident Asian investment grade bonds will positively contribute to the investment portfolio.

Important Information for Customers