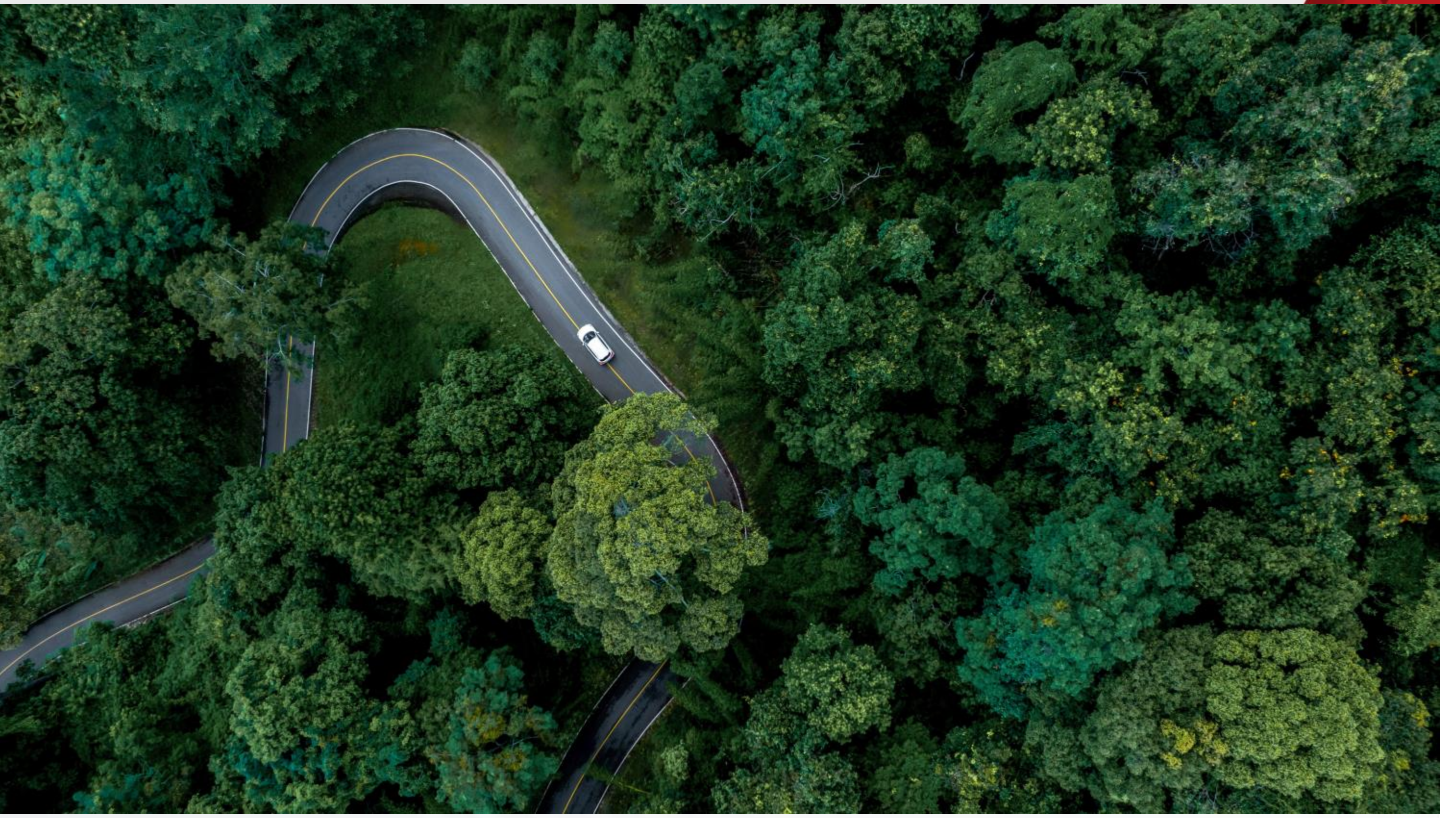

# MARKET INSIGHTS

July 2024

# Equity

**At the end of June, the government held various meetings and repeatedly emphasized the promotion of high-quality development and aiming to guide long-term funds. One of the purposes is to let insurance funds invest in entrepreneurship and create a more favorable market environment for venture capital. Additionally, the government is also deepening to further opening up key sectors to foreign investment, implementing the requirement to remove restrictions on foreign access to the manufacturing industry, and launching new rounds of pilot measures to expand the opening of the service industry. As overseas funds' substantial increase in China's equity asset allocation comes to a basic conclusion, industry allocation will mainly adopt a barbell strategy. On one hand, it will over-allocate to stable benefit industries such as high dividend stocks, and on the other hand, it will follow policy changes and opportunistically over-allocate to industries that may benefit from policy relaxations.**

## Market Performance

In June, the MSCI China Index performed weakly, ultimately declining by 2.84%. The domestic economy's slow recovery in internal growth momentum led to a decline in several weekly production indicators on a month-on-month and year-on-year basis. The real estate market showed improvement in sales after the policy measures introduced on May 17th, but investment was constrained by transmission lags and may experience a slow recovery. The transaction area of commodity housing in the top 30 cities increased by 19.4% compared to the previous month but decreased by 16.6% compared to the same period last year. The index for listing prices of second-hand houses continued to weaken by 0.3% on a monthly basis. Consumer spending may face pressure in June, as passenger car sales weakened both month-on-month and year-on-year. Retail and wholesale sales of passenger cars for the week ending June 30th both declined by double-digit percentages compared to the same period last year. On June 25th, Premier Li Keqiang attended the opening ceremony of the 2024 Summer Davos Forum and emphasized the importance of maintaining the direction of building an open world economy, focusing on strengthening the foundation of economic development and implementing a combination of short-term and long-term measures to promote high-quality development. On June 27th, the Politburo of the Communist Party of China held a meeting to discuss further comprehensive deepening of reforms and advancing the development of a Chinese-style modernization. It was decided that the Third Plenary Session of the 20th Central Committee of the Communist Party of China would be held in Beijing from July 15th to 18th.

| **Greater China Indices** | Jun Close | Monthly % Change | YTD % | 52 Week Low | 52 Week High |
|---|---|---|---|---|---|
| CSI 300 | 3765.27 | -3.30 | 0.89 | 3108.35 | 4064.36 |
| MSCI China | 60.57 | -2.84 | 3.43 | 48.75 | 67.27 |
| HSI | 18382.06 | -2.00 | 3.94 | 14794.16 | 20361.03 |
| HSCEI | 6332.42 | -0.95 | 9.77 | 4943.24 | 7023.88 |
| | | | | | |
| **Global Indices** | | | | | |
| S&P 500 | 4507.66 | 3.47 | 14.48 | 4103.78 | 5539.27 |
| Dow Jones Industrial Average | 34721.91 | 1.12 | 3.79 | 32327.20 | 40077.40 |
| Nasdaq Composite | 14034.97 | 5.96 | 18.13 | 12543.86 | 18188.30 |
| FTSE 100 | 7439.13 | -1.34 | 5.57 | 7215.76 | 8474.41 |
| DAX 30 | 15947.08 | -1.42 | 8.86 | 14630.21 | 18892.92 |
| Nikkei 225 | 32619.34 | 2.85 | 18.28 | 30487.67 | 41100.13 |

## Economic Data

China’s manufacturing PMI index stayed flat at 49.5 in June. Among major sub-indexes of NBS manufacturing PMI, the new orders sub-index edged down to 49.5 from 49.6, the output sub-index decreased to 50.6 from 50.8, while the employment sub-index stayed flat at 48. The non-manufacturing PMI fell to 50.5 in June from 51.1 in May, owing to a deceleration of activities in both the construction and services sector in June.

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The services PMI decreased to 50.2 from 50.5. According to the survey, the PMIs of transport service industries such as postal, telecommunication and satellite transmission services, airline transportation and insurance were above 55, while the PMIs of capital market services and real estate services industries were below 50 in June. The construction PMI fell to 52.3 from 54.4. NBS commented that the construction activity was impacted by adverse weather conditions such as heavy rainfall in southern regions in June.

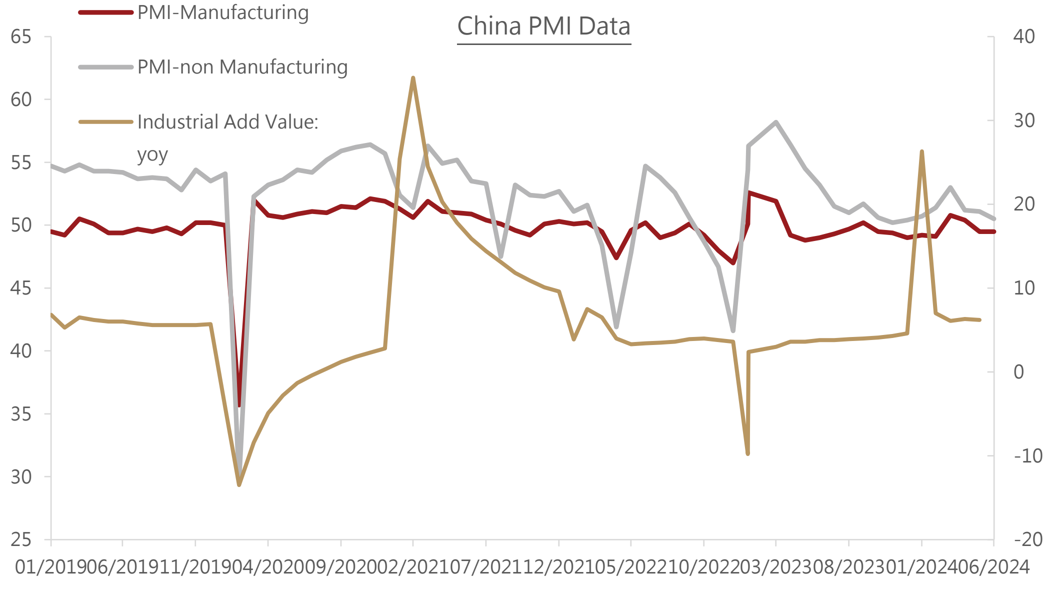
## Outlook

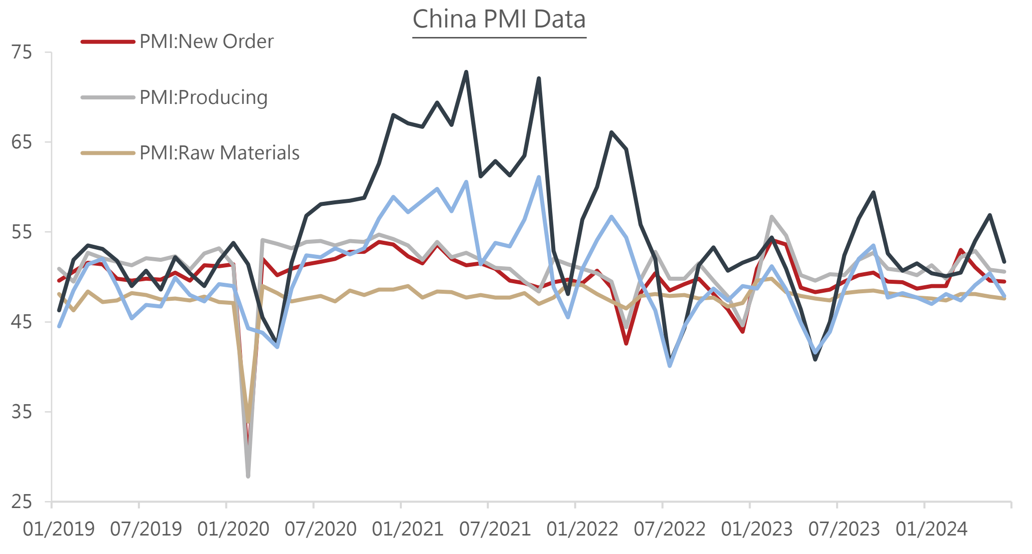
Looking forward, we maintain our long-term positive view of the Chinese equity market. According to data from Centaline Property, the total transaction volume of pre-owned houses in Beijing exceeded 2,000 units during the first weekend after the implementation of the "517" real estate policy, indicating that the recent combination of the real estate polices has shown significant effectiveness. At the end of June, the government held various meetings and repeatedly emphasized the promotion of high-quality development and aiming to guide long-term funds. One of the purposes is to let insurance funds invest in entrepreneurship and create a more favorable market environment for venture capital. Additionally, the government is also deepening to further opening up key sectors to foreign investment, implementing the requirement to remove restrictions on foreign access to the manufacturing industry, and launching new rounds of pilot measures to expand the opening of the service industry. As overseas funds' substantial increase in China's equity asset allocation comes to a basic conclusion, industry allocation will mainly adopt a barbell strategy. On one hand, it will over-allocate to stable benefit industries such as high dividend stocks, and on the other hand, it will follow policy changes and opportunistically over-allocate to industries that may benefit from policy relaxations.

In terms of portfolio positioning, we will continue to seek a balance between value and growth. We continue to focus on the long-term policy beneficiaries (e.g. software localization and advanced manufacturing) and economic recovery-related opportunities (e.g. consumer, Internet, and financials). We will prudently pay attention to some thematic opportunities, including AI and SOE re-rating.

## Risk

Sino-US relationship worsens than expectation. International geopolitics worsens than expectation; China's economy recovers less than expected.




China PMI Data
PMI:New Order
PMI:Producing
PMI:Raw Materials
75
65
55
45
35
25
01/2019
07/2019
01/2020
07/2020
01/2021
07/2021
01/2022
07/2022
01/2023
07/2023
01/2024


China Economy Activities
40
30
20
10
0
-10
-20
-30
200
150
100
50
0
-50
-100
-150
-200
01/2016
07/2016
01/2017
07/2017
01/2018
07/2018
01/2019
07/2019
01/2020
07/2020
01/2021
07/2021
01/2022
07/2022
01/2023
07/2023
FAI: yoy
Total Retail Sales of Consumer Goods: yoy
Net Export: yoy

# Fixed Income

**The market has seen an increase in rate cut expectations in June, which is consistent with our previous assessment of the market's overpricing and failure to land. We believe the overall US economy will continue to exhibit a tepid and marginally weakening trend, but is still far from a recession. After two consecutive "good" inflation readings, the high base effect and inflation reversals in other countries make the US inflation trajectory anything but smooth going forward. Overall, we maintain our view that the Fed will begin easing in Q3, but the terminal point of this rate cut cycle may be higher given the backdrop of deglobalization and post-Trump tax cuts and tariff reductions. The possibility of the Fed easing earlier cannot be ruled out either. In Europe, the French election reflects the risks to the overall political landscape, and there may still be X-factors going forward. Japan, on the other hand, is expected to initiate tapering in July to address its persistently depreciating currency.**

## Market Performance

In June markets have continued to experience volatility. Although the FOMC meeting lowered the full-year rate cut guidance, with the improvement in inflation and the softening of some economic data, the market has priced in a higher possibility of the first rate cut. The strong performance of far-right parties in European elections has become an X-factor for the market. Overall, US Treasury yields have declined slightly. In terms of asset classes, US assets have relatively outperformed against the backdrop of a strong US dollar, while the performance of commodities has been mixed.

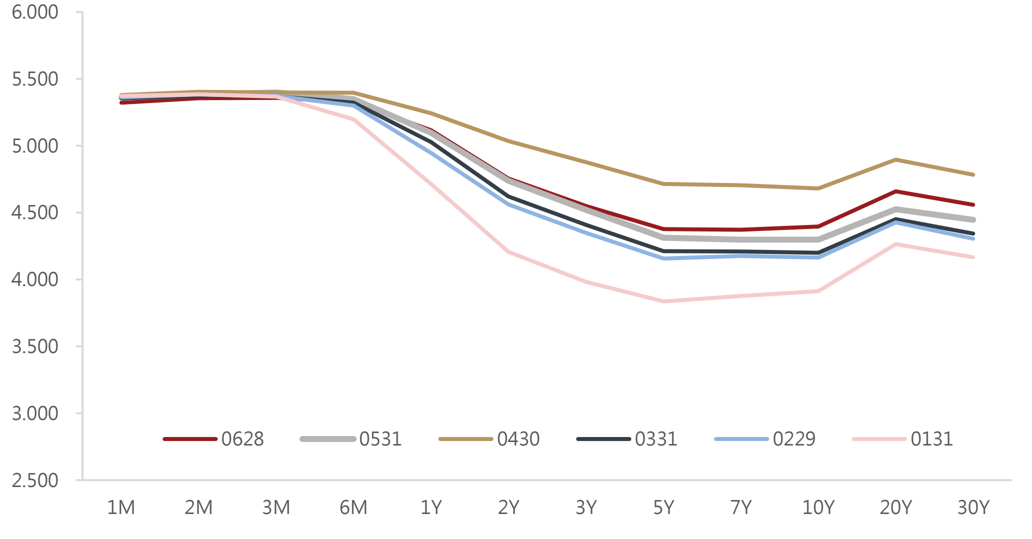
| United States | Last Price % | 1M chg bp | YTD chg bps | 52W low% | 52W high% |
|---|---|---|---|---|---|
| 2Y | 4.75 | -12 | 50 | 4.12 | 5.26 |
| 5Y | 4.38 | -13 | 53 | 3.75 | 4.99 |
| 7Y | 4.37 | -13 | 49 | 3.78 | 5.03 |
| 10Y | 4.40 | -10 | 52 | 3.72 | 5.02 |
| 30Y | 4.56 | -9 | 53 | 3.81 | 5.18 |

| China | Last Price % | 1M chg bp | YTD chg bps | 52W low% | 52W high% |
|---|---|---|---|---|---|
| 3Y | 1.80 | -13 | -49 | 1.77 | 2.53 |
| 5Y | 1.97 | -11 | -42 | 1.95 | 2.64 |
| 7Y | 2.10 | -14 | -43 | 2.08 | 2.75 |
| 10Y | 2.21 | -11 | -35 | 2.18 | 2.74 |
| 30Y | 2.43 | -14 | -41 | 2.40 | 3.04 |

| Japan | Last Price % | 1M chg bp | YTD chg bps | 52W low% | 52W high% |
|---|---|---|---|---|---|
| 2Y | 0.37 | -4 | 31 | -0.07 | 0.41 |
| 5Y | 0.59 | -6 | 38 | 0.06 | 0.66 |
| 7Y | 0.74 | -3 | 38 | 0.18 | 0.78 |
| 10Y | 1.06 | -1 | 44 | 0.38 | 1.11 |
| 30Y | 2.25 | 3 | 62 | 1.20 | 2.31 |

| Germany | Last Price % | 1M chg bp | YTD chg bps | 52W low% | 52W high% |
|---|---|---|---|---|---|
| 2Y | 2.83 | -26 | 43 | 2.36 | 3.36 |
| 5Y | 2.48 | -23 | 53 | 1.86 | 2.93 |
| 7Y | 2.46 | -19 | 52 | 1.83 | 2.94 |
| 10Y | 2.50 | -16 | 48 | 1.89 | 3.03 |
| 30Y | 2.69 | -9 | 43 | 2.12 | 3.26 |

U.S. Treasury yield curve

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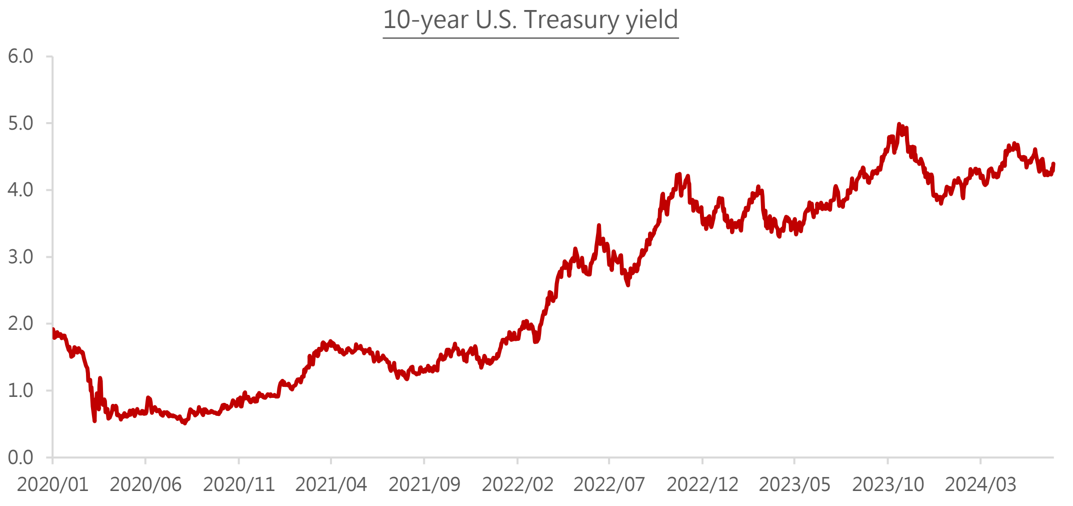


US Treasury yields have remained volatile. The inversion of the 2-10 year yield curve has gradually deepened over much of the period. At the end of the month, the increase in the CBO's projection of the fiscal deficit and Trump's advantage in the presidential debate have led to heightened market concerns about long-term debt supply, resulting in a bear-steepening of the yield curve. In the credit market, overall issuance has cooled in Q2, with credit spreads widening slightly from their lows over the month. European (especially French) performance has been relatively lagging, and emerging markets have also seen some pullback. For Chinese credits, the decline in rates and the drop in equities have led to a slight widening of spreads for some higher-beta names.

| **CDX Index** | Current Value | 1M chg bp | YTD chg bps | 52W low% | 52W high% |
|---|---|---|---|---|---|
| IG CDX | 53 | 4 | (3) | 48 | 83 |
| HY CDX | 344 | 11 | (12) | 309 | 533 |
| EM CDX | 175 | 12 | 23 | 156 | 247 |
| **Bond index** | | | | | |
| ICE Asian Dollar Corporate | 457 | 0.9% | 2.7% | 416 | 459 |
| ICE China Issuers Dollar IG Corporate | 214 | 0.8% | 2.0% | 198 | 215 |
| ICE China Issuers Dollar HY Corporate | 174 | 1.3% | 13.5% | 143 | 174 |
| ICE US Corporate | 3239 | 0.6% | 0.0% | 2929 | 3270 |
| ICE US High Yield | 1631 | 0.9% | 2.6% | 1457 | 1633 |
| ICE Emerging Markets Corporate | 444 | 0.9% | 2.6% | 401 | 446 |
| Bloomberg Global-Aggregate | 456 | 0.1% | -3.2% | 429 | 473 |
| Bloomberg Global-Aggregate 1-3 Year | 172 | -0.1% | -1.4% | 166 | 175 |

## Economic Data

The May US CPI reading was better than expected, with the core and super-core CPI readings showing a significant cooling. Employment has been relatively unsettled due to immigration disruptions, but the overall labor market is trending towards greater balance. Furthermore, US consumer data has softened further, and investment has not rebounded as expected. In Europe, most data has been in line with market expectations. After completing the first rate cut, the ECB stated that future policy will be data-dependent. The uncertainty surrounding the French parliamentary election has led to a rapid widening of the Germany-France yield spread. Japan's economic data has been strong, but the yen has remained under pressure.

## Outlook

The market has seen an increase in rate cut expectations in June, which is consistent with our previous assessment of the market's overpricing and failure to land. We believe the overall US economy will continue to exhibit a tepid and marginally weakening trend, but is still far from a recession. After two consecutive "good" inflation readings, the high base effect and inflation reversals in other countries make the US inflation trajectory anything but smooth going forward. Overall, we maintain our view that the Fed will begin easing in Q3, but the terminal point of this rate cut cycle may be higher given the backdrop of deglobalization and post-Trump tax cuts and tariff reductions. The possibility of the Fed easing earlier cannot be ruled out either. In Europe, the French election reflects the risks to the overall political landscape, and there may still be X-factors going forward. Japan, on the other hand, is expected to initiate tapering in July to address its persistently depreciating currency.

Regarding interest rates, as rate cuts draw near, the upside potential for short-term rates is limited. Long-end bonds, however, are influenced by supply-demand dynamics, economic factors, and political developments. In the medium term, the steepening of the yield curve remains relatively certain, with close attention to how the progress of the US election impacts the macroeconomic environment. In the credit market, although spread volatility has declined, the negative correlation between credit spreads and rates has been pronounced so far this year. Assuming the economy can achieve a soft landing, this dynamic is expected to continue, providing tactical trading opportunities. As the yield curve steepens, the credit spread curve may flatten again. From a fundamental perspective, as the US economy slows, the profitability and credit metrics of some industries may come under gradual pressure. Regarding valuations, credit spreads widened in June but remain significantly below year-end 2022 levels. Credit is one of the few asset classes globally that is fully priced for a soft landing. While the European elections have limited impact on most US corporates, a cautious stance on European credit is warranted. From a technical perspective, bond supply may continue to moderate in the second half, and if the Fed initiates rate cuts, capital may flow from equities or money markets into fixed income. For Chinese credits, the overall impact of RMB exchange rate and China's economic pressures is manageable, and investors have strong demand for bonds with attractive all-in yields, making them a viable diversification option.

For monetary policy, the PBOC kept the MLF and LPR rates unchanged. The market expects 20-30bps of LPR cuts in the second half of the year. Considering the flat MLF rollover in May and the reduced scale of MLF operations in March, April, and June, the signaling effect of the MLF on the market has diminished. China's economic data for June has been stable and drained of excess, with PPI confirming a bottom but not a clear inflection point, having limited impact on the market. In terms of fiscal supply, the pace of local government bond issuance this year has been relatively slow. Half the year has passed while only one-third of the new issuance quota has been used, further exacerbating the asset shortage. The issuance pace is expected to accelerate in the second half of the year, especially in Q3, with the rollout of special purpose bonds, local government bonds, and the continued issuance of special treasury bonds.

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On the first of July, the People's Bank of China (PBOC) conducted a repurchase operation with primary dealers, increasing the supply of government bonds in the market, similar to short-selling in the equity market. This has pushed up yields, especially on the long end, with the overall curve shifting up by around 7bps. This move could be interpreted as the PBOC signaling that the 2.5%-3% range is a reasonable target for long-term government bond yields, in line with our previous assessment of the 10-year and 30-year yields being within the 2.2%-2.4% and 2.4%-2.6% ranges, respectively. This year, financial institutions have been extending duration and increasing their allocation to bond funds, as long-dated bond yields have approached funding rates, creating a seesaw effect with the equity market. The excessive pursuit of long-term bonds has exacerbated the bearish sentiment, and financial institutions' large exposures to extended durations pose potential risks from market volatility. However, the PBOC has not made this bond operation public nor increased liquidity withdrawal, suggesting that the central bank is more focused on managing market expectations and controlling the pace of yield adjustments, rather than a fundamental shift in policy direction. In the near term, closer observation of the frequency and scale of these operations is warranted, and the bond market bulls are likely to remain cautious.

The spot USDCNH exchange rate has risen from 7.26 to above 7.30, confirming a breakout from the 7.23-7.28 trading range. The next target levels are the previous highs of 7.35-7.37, indicating the US dollar will maintain its strength. Chinese government bond yields continued to decline across the curve in June, with the 5-year and 10-year yields down 11bps, and the 2-year and 30-year yields down 14bps. In the short term, it is not recommended to enter the market too quickly on rebounds, as the risk-reward ratio is generally not favorable given the proximity of the yield floor. However, the long-term bullish view on bonds remains unchanged. Offshore CNH swap rates have been range-bound, but considering the current upward pressure on the spot rate, there is an opportunity tighten. There is a possibility of offshore CNH rates rising in July, providing a chance to capture hedging opportunities, with the current hedging cost around 2.5-2.6%.

Going into July, the focus on the political front will be on two major meetings: the Third Plenary Session from July 15-18, which is expected to discuss further reform measures, and the Politburo meeting on July 24, which may provide insights into the government's stance on the real estate sector, local government hidden debt, and the capital markets. From a seasonal perspective, bond yields in China tend to decline more often in July. On the U.S. election front, the next key event to watch is the Democratic National Convention in Chicago in August, which may potentially involve a change in the party's presidential nominee from the incumbent Joe Biden.

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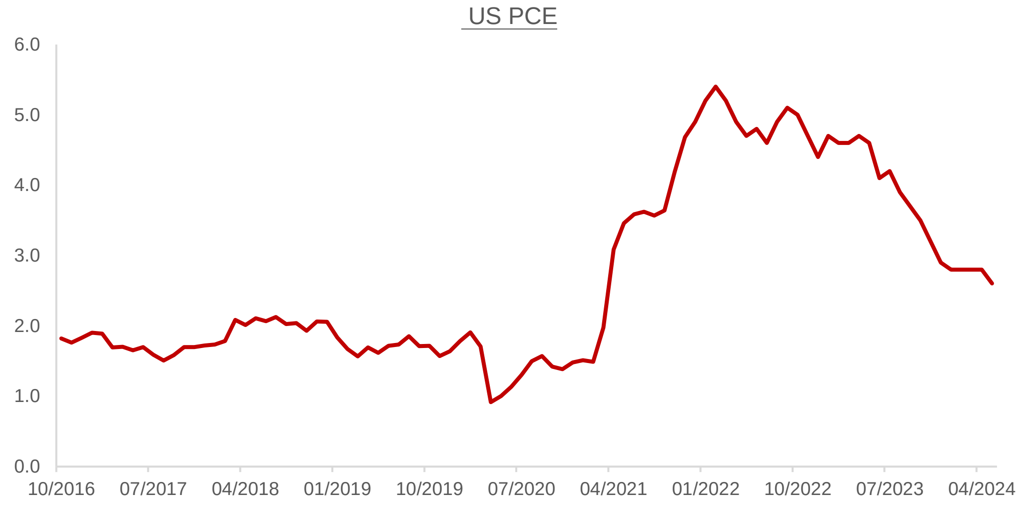



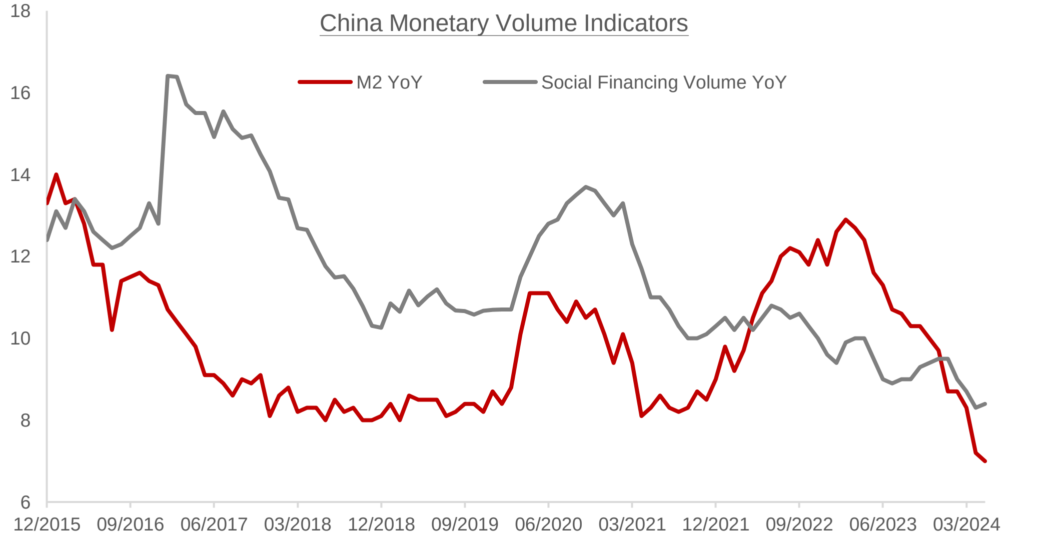


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