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CSOP Asset Management

China Market Outlook 2nd Half 2023

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CSOP 2H2023 Outlook

China Recovery to Continue

Aug 2023

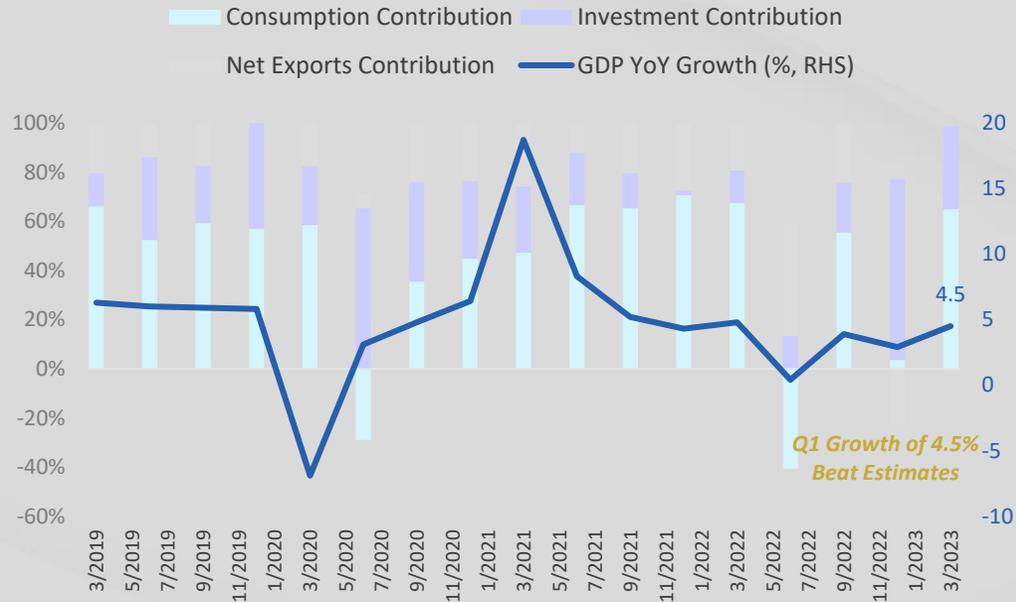


Where Are We in Economic Recovery?

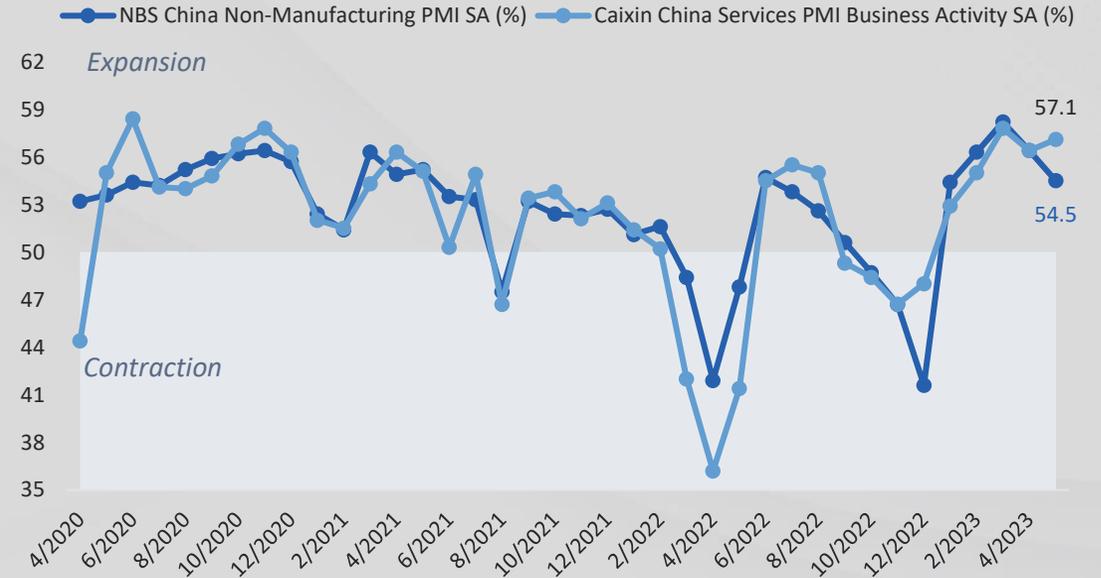
Reopening Completed

The completion of reopening drove a better-than-expected economic recovery in 1Q23, led by COVID-hit segments in service industry. Strong service PMI shows endogenous and sustainable recovery in service demand.

China Achieved Strong Rebound in Q1, Led by Consumption*



Service PMI remain at High Level#



Source: *Bloomberg, CSOP. #Bloomberg. 2018/1-2023/5.

Where Are We in Economic Recovery?

Growth Concerns Raised

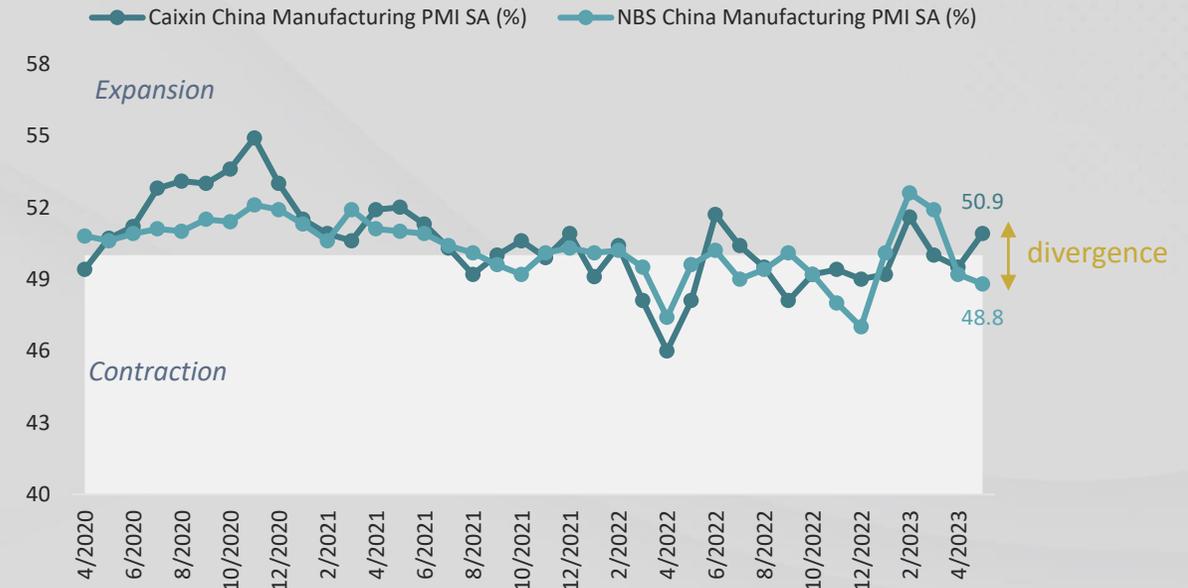
Disappointing April data raised concerns about whether the growth momentum can continue. Weak goods demand globally dragged the recovery of manufacturing industries and exports, strong export growth in March is not sustainable, and consumption momentum seems to weaken.

China April Macro Data Raised Growth Concerns[^]

	Mar. 23 YoY Change (%)	Apr. 23 YoY Change (%)
Industrial Value Added	3.9	5.6
Retail sales	10.6	18.4
Fixed asset investment	4.8	3.9
Manufacturing FAI	6.2	5.3
Infrastructure FAI	9.9	7.9
Real estate development FAI	-5.9	-7.3
Property Sales (floor space)	0.1	5.5
Property new starts (floor space)	-29.1	-27.3
Exports (in USD)	14.8	8.5
Imports (in USD)	-1.4	-7.9

Diverged PMI Shows Unbalanced Recovery

NBS Manufacturing PMI Edged Down While Caixin PMI Picked Up[#]



In Historical Experience, Weakness in Manufacturing PMI May be a Precursor to Policy Easing...

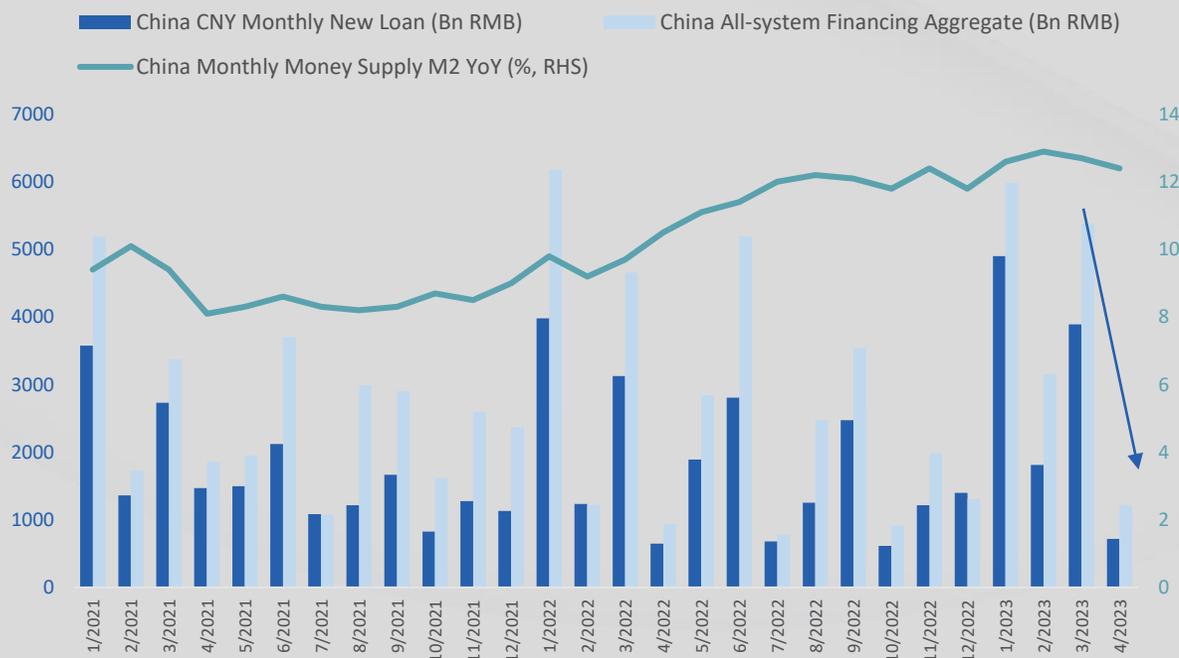
Source: [^]National Bureau of Statistics of China, Bloomberg. [#]Bloomberg. 2018/1-2023/5.

Monetary Policy to Remain Accommodative

In the first half, monetary policy remained prudent easing and liquidity is reasonably sufficient, with **growing M2, one RRR cut of 25bps and saving rates reduction by several banks**. But with sluggish real demand, the policy transformation to real economy may take more time.

The monetary policy is expected to remain accommodative to support the economy, and **a new round of rate cuts has begun**.

Liquidity Remains Sufficient, But Sluggish Real Demand Led to Declining Loans[^]



Source: [^]Bloomberg. *PBOC, official websites of China commercial banks

“Stimulus Mode” is On -- A New Round of Rate Cuts Has Begun*

Interest Rates

Deposit Rates

China’s six state-owned commercial banks cut demand deposit rates to 0.2% from 0.25% and cut 5-year time deposit rate to 2.5% from 2.65% on 8 June
China joint-stock banks cut rates on demand deposits by 5 basis points (bps) to 0.2%, 2-year time deposits by 10 bps, and three-year and 5-year time deposits by 15 bps on 12 June

7-day Reverse Repo Rate

PBOC cut the interest rate on 7-day reverse repurchase operations (repo) to 1.9% from 2.0% on 13 June

SLF Rate

PBOC cut rates on its standing lending facility (SLF) by a 10 bps on 13 June. After the adjustment, the rate on the overnight SLF was reduced to 2.75%, while rates for the seven-day SLF fell to 2.9% and for the one-month SLF to 3.25%.

1-year MLF Rate

PBOC lowered the rate on 1-year medium-term lending facility (MLF) loans by 10 bps to 2.65% from 2.75% on 15 June

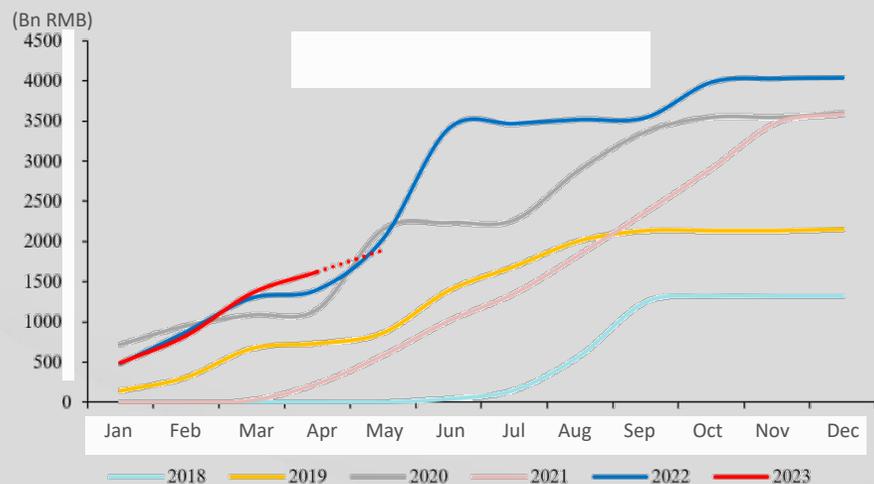
Expansionary Fiscal Policy to be Expected

In the first 4 months of 2023, fiscal policy stance is neutral to positive and fiscal expenditures remain balanced.

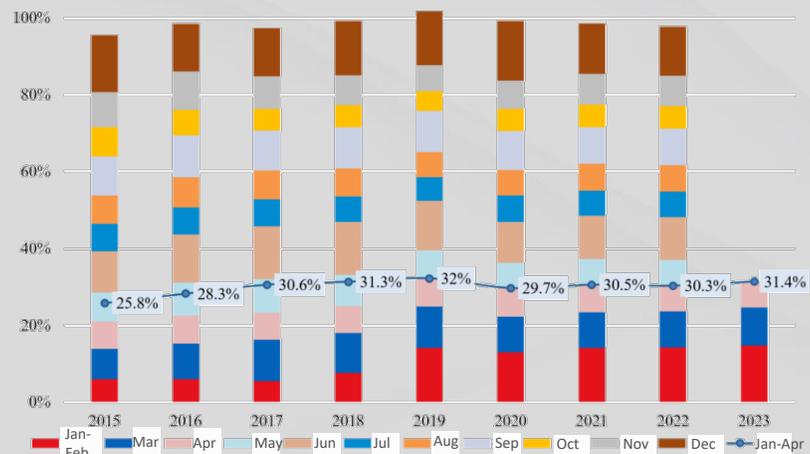
Fiscal policy is the key to boosting real demand. If China's growth momentum continue to weaken with disappointing manufacturing/consumption activities, we look forward to seeing more fiscal stimulus to support growth, for example, accelerated issuance of special bonds and issuance of special government bonds to boost infrastructure investment, rolling out some targeted consumption support.

Fiscal Policies Were Supportive in 1Q23 Despite Slowing Down in April and May

Special Bond Issuance Is Pre-issued, But Weakened in May*



% Completion of Annual Public Finance Expenditure Budget in Jan-Apr23 is the Second-highest level in Recent 10 Years*



Potential Fiscal Stimulus

Accelerated issuance of special bonds

Issuance of Special Government Bonds

Issuance of Policy Bank Bonds

.....



Boost Infrastructure Investment

Targeted Consumption Support, like new energy vehicles

.....

Source: *Wind, Huachuang Securities.

Property Improved But Still a Drag

Housing sales improved partly on pent-up demand in 1Q23 but weaken sequentially in April and May.

The recovery of the property sector requires more supportive policies such as ① further cuts in 5-year LPR rate (benchmark rate for residential mortgage), ② easing purchase restrictions in Tier1-2 cities, or ③ even allowing price decrease to bring homebuyers back.

Housing Sales Continued to Recover in YoY basis but Dropped a lot Sequentially*

Month	Monthly attributable sales - yoy%			Monthly attributable sales - mom%			YTD attributable sales - yoy%		
	Top 30	Top 50	Top 100	Top 30	Top 50	Top 100	Top 30	Top 50	Top 100
2021-01	59%	65%	67%	-35%	-37%	-43%	59%	65%	67%
2021-02	117%	131%	148%	-12%	-13%	-13%	82%	90%	97%
2021-03	43%	49%	53%	38%	42%	41%	64%	71%	77%
2021-04	23%	25%	28%	-3%	-5%	-3%	50%	56%	60%
2021-05	14%	15%	15%	5%	7%	6%	40%	44%	47%
2021-06	-6%	-5%	-3%	9%	7%	11%	28%	31%	33%
2021-07	-7%	-6%	-8%	-22%	-22%	-27%	22%	24%	26%
2021-08	-16%	-16%	-21%	-14%	-12%	-15%	16%	19%	19%
2021-09	-35%	-35%	-36%	-5%	-7%	-4%	9%	10%	10%
2021-10	-35%	-33%	-34%	2%	5%	3%	3%	5%	5%
2021-11	-39%	-41%	-43%	-11%	-9%	-8%	-2%	-1%	-1%
2021-12	-33%	-34%	-39%	31%	29%	34%	-5%	-5%	-6%
2022-01	-43%	-42%	-42%	-45%	-45%	-47%	-43%	-42%	-42%
2022-02	-51%	-50%	-48%	-25%	-25%	-22%	-47%	-46%	-45%
2022-03	-53%	-56%	-54%	35%	26%	23%	-49%	-50%	-49%
2022-04	-59%	-58%	-59%	-16%	-11%	-13%	-52%	-52%	-51%
2022-05	-56%	-58%	-59%	11%	8%	6%	-53%	-54%	-53%
2022-06	-37%	-39%	-41%	58%	56%	60%	-50%	-51%	-51%
2022-07	-45%	-46%	-43%	-31%	-31%	-29%	-49%	-50%	-50%
2022-08	-31%	-35%	-31%	7%	6%	3%	-47%	-48%	-48%
2022-09	-29%	-33%	-30%	-2%	-4%	-2%	-46%	-47%	-46%
2022-10	-28%	-32%	-31%	3%	6%	1%	-44%	-46%	-45%
2022-11	-20%	-27%	-24%	0%	-2%	2%	-42%	-44%	-44%
2022-12	-20%	-27%	-30%	31%	28%	24%	-41%	-43%	-42%
2023-01	-25%	-30%	-32%	-48%	-48%	-48%	-25%	-30%	-32%
2023-02	33%	25%	16%	34%	34%	35%	0%	-7%	-11%
2023-03	37%	36%	31%	39%	38%	38%	13%	8%	4%
2023-04	38%	33%	32%	-16%	-13%	-11%	19%	14%	11%
2023-05	8%	5%	3%	-13%	-15%	-18%	17%	12%	9%

Property Investment Growth Stay Sluggish this year, with Housing Completions (19% YoY YTD in volume terms) Remaining a Key Cushion^



Source: *CRIC (China Real Estate Information Corporation), Morgan Stanley Research. ^Morgan Stanley.

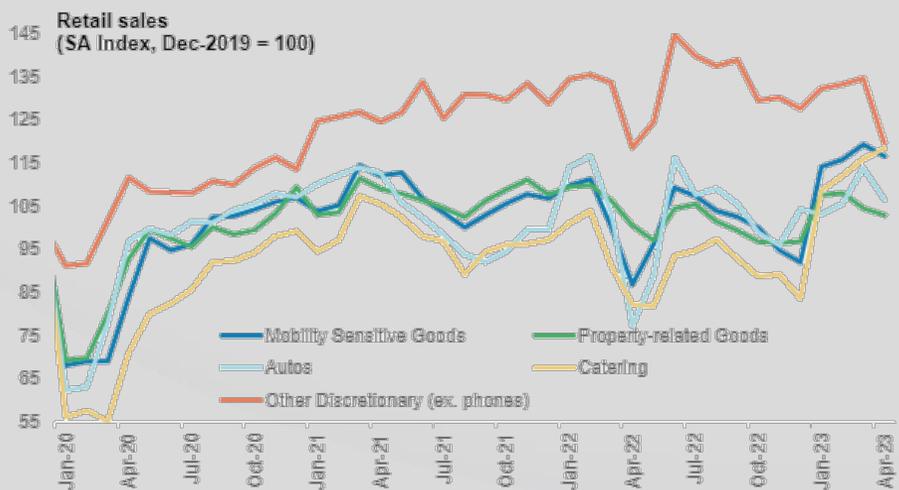
Consumption Recovery Continue but Normalize

Consumption was the largest contributor to the Q1 strong economic rebound, but the recovery is uneven. The first wave consumption rebound boosted by rapid reopening is likely peaking, while lagging employment recovery, increasing saving willingness, traumatized household balance sheet and well below pre-COVID levels of confidence lead to the weakness in both consumption willingness and capabilities, and hinder consumption from growing further.

We expect that service consumption recovery remains endogenous and strong, but goods consumption takes more time to pick up and need the help from targeted consumption stimulus and property supportive policies.

- Some auto consumption supportive policies have been introduced recently: the Ministry of Commerce of China announced a nationwide campaign to promote automobile purchases from June to December this year on June 8; An executive meeting of the State Council to study policies and measures to promote the high-quality development of the new energy vehicle industry on 2 June.

Strong but Uneven Consumption Recovery*

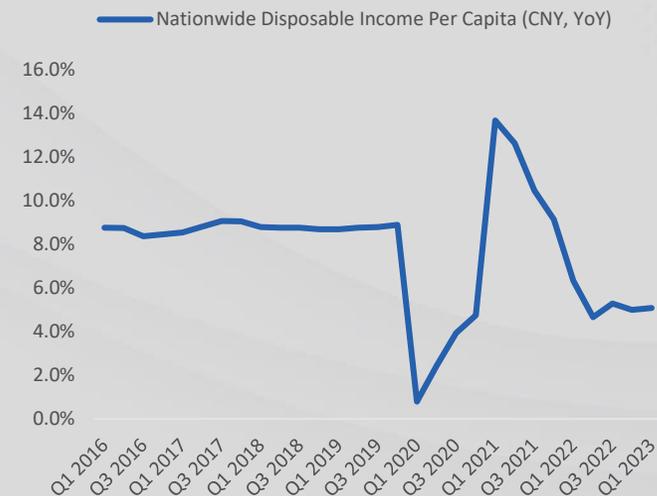


Dual Weakness in Willingness and Capabilities Imply More Policy Stimulus Needed

Consumer Confidence Recover but Well Below 2019 Level[^]



The Central Tendency of Disposable Income Lower than 2019 Level^{^^}



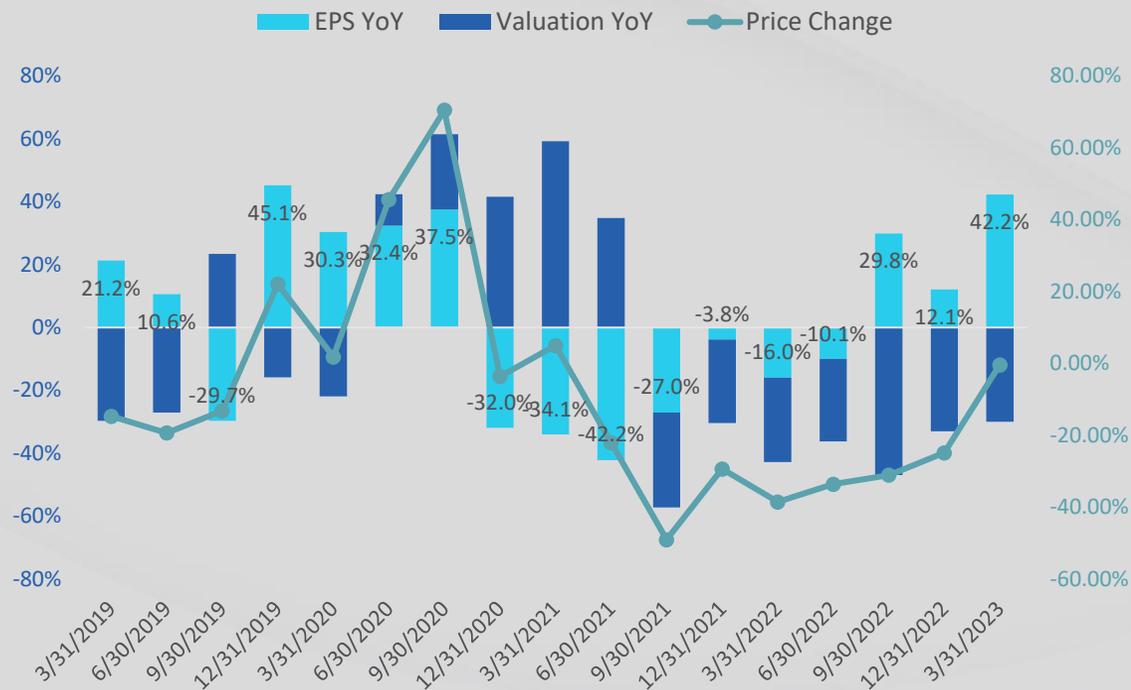
Source: *Morgan Stanley. [^]Wind, CICC. ^{^^}Bloomberg.

Valuation Pressure is the Main Reason for Recent Correction

The fundamental side of China's tech stocks have significantly improved, with supportive statements from central government and strong earnings growth in 1Q23. But the unresolved geopolitical conflict posed pressure on the valuation side, making a negative contribution to the stock price movement.

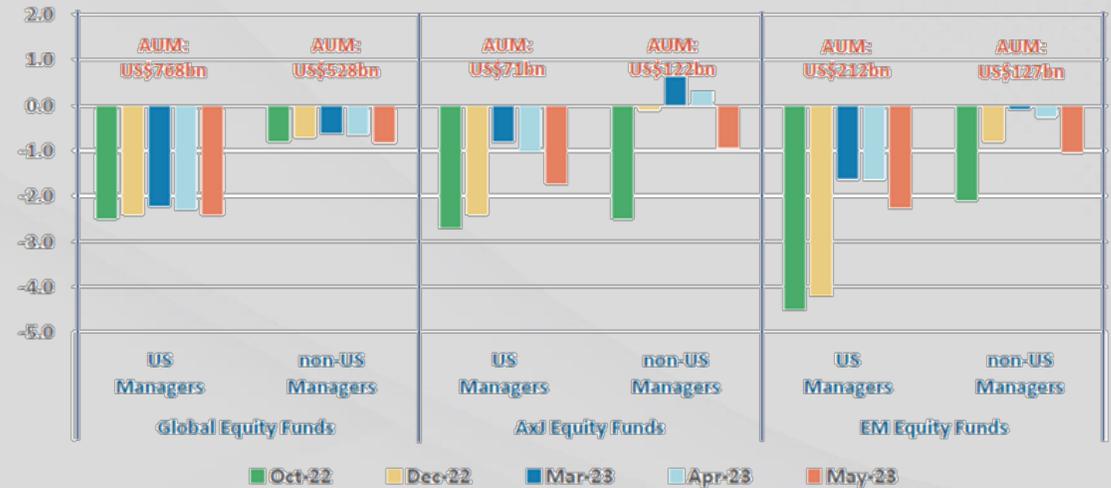
Earnings Strong Beat But Valuation Drag the Q1 Performance

The Valuation and Earnings Contribution of Price Change of Selected Tech Giants*



Long-only Mandates Notably Reduced Their China Exposure in April and May

Active Weights of mainland China/HK Equities by Regional Fund Category and Manager Domicile^



Source: *Bloomberg, CSOP estimation. ^MorningStar, FactSet, EPFR, Morgan Stanley Research. As of 2023/5/31.

More Events to Watch

In the Politburo meeting concluded in the end of April, the policy stance remained pro-growth to ensure the sustainability of economic recovery. We expect the upcoming July Political to disclose policy tone change and the rumored US-China talks recently to release some positive signals.

Politburo: Pro-growth Stance[^]

 Politburo concluded on 28 April 2023 **continues to prioritize growth with accommodative policy and a pro-business stance.** The wording on fiscal and monetary policy came in identical to that from the December 2022 meeting and NPC

Policy Focus	Key Takeaway
Policy Easing	<ul style="list-style-type: none"> - Despite a strong start, aggregate demand has not fully recovered YTD - Create policy synergy to facilitate a self-sustaining recovery: 1) expansionary fiscal policy 2) accommodative monetary policy
Private Sector	<ul style="list-style-type: none"> - Big tech firms encouraged to explore cutting-edge innovation - Resolve longstanding corporate account payables - Pilot trade zones may be permitted to implement regulations in line with international standards
Property Sector	<ul style="list-style-type: none"> - “Houses are for living, not for speculation” - Support first-home and home improvement demand - Ensure home completion and delivery

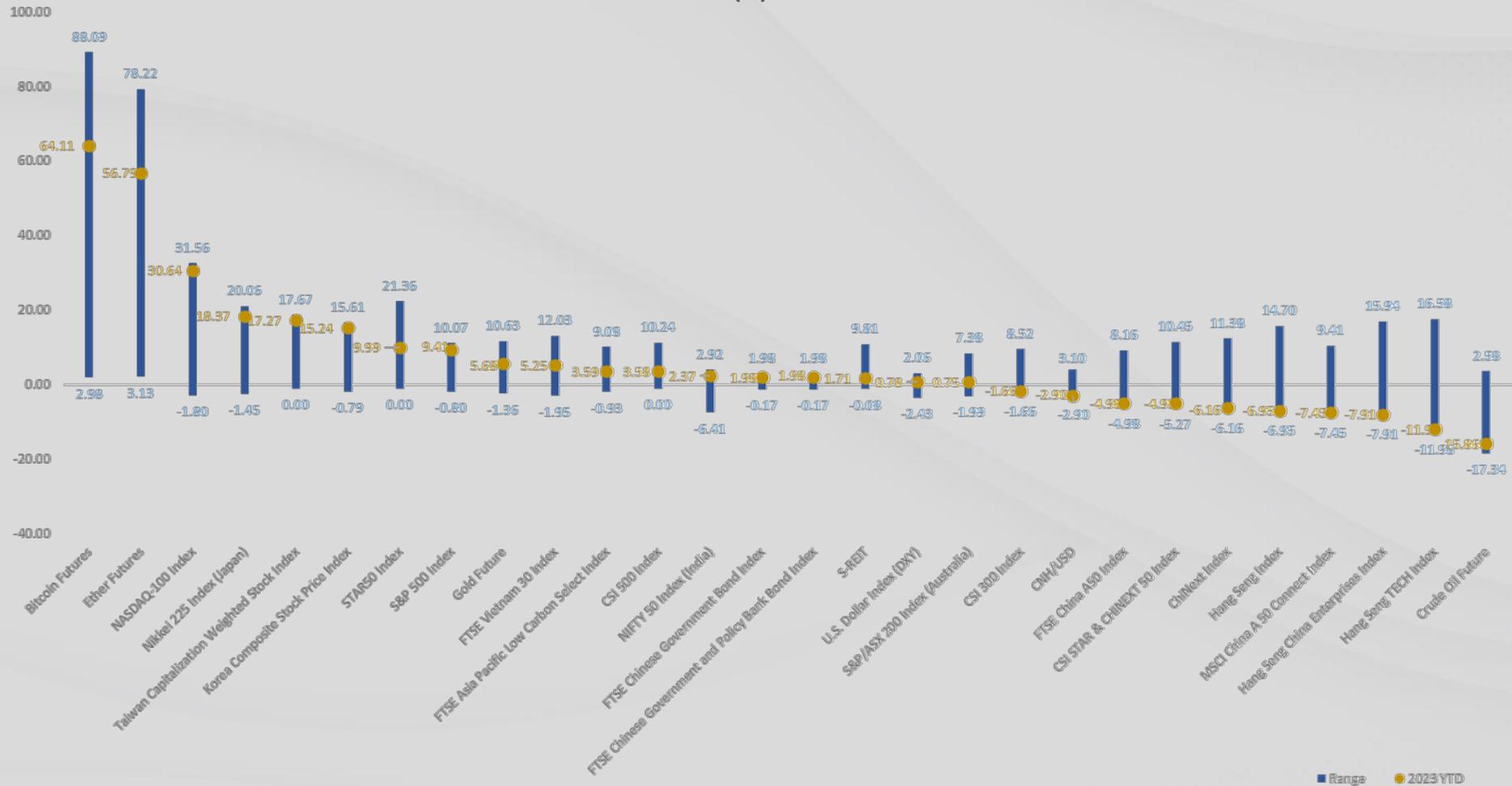
More Events to Watch in 2H23*

Time	Event
Jun. 2023	US Secretary of State Antony Blinken set to travel to China
Jul. 2023	Politburo meeting: key time window to watch for policy tone change
Aug. 2023	BRICS summit in South Africa
Sep.-Oct. 2023	<ul style="list-style-type: none"> • The Third Belt and Road Forum for International Cooperation: The 10th anniversary of Belt and Road Initiative • 2023 G20 New Delhi summit in September
Nov. 2023	<ul style="list-style-type: none"> • The Third Plenary Session of the 20th Central Committee of the Communist Party of China (三中全会): Focus on economic development and economic system reform • APEC CEO Summit 2023 in San Francisco, California
Dec. 2023	<ul style="list-style-type: none"> • Central Economic Work Conference • Politburo meeting

Source: [^]April Politburo. *Compiled by CSOP.

1H2023 Market Review - Performance

The Total Returns (%) in the first 5 months of 2023



Source: Bloomberg, as of 2023/5/31. The two ends of the blue bars show the lowest and highest returns at any point this year to date, and the gold dots represent current year-to-date returns. Gold future refers to the excess return index of Solactive Gold 1-Day Rolling Futures Index. Crude oil future refers to the excess return index of Solactive WTI 1-Day Rolling Futures Index. ChiNext Index, FTSE Chinese Government Bond Index, Bloomberg Barclays China Treasury + Policy Bank Index are the total return indexes. Bitcoin futures and ether futures are both the price levels of CME futures active contracts. The remaining are net total return indexes.

Investment Implications

With the first phase of strong economic recovery completed driven by China's rapid recovery, we stand in a crossroad amid lots of unresolved concerns. Whether there would be positive signals in geopolitical issues and whether the expectations on expansionary policy stimulus would be the key to look at.

Scenarios

Macro Policies Remain Unchanged
No Positive Signal in Geopolitical Issues

More Stimulus Introduced Such as LPR cut, expanding fiscal spending
And/or
Positive Signal in Geopolitical Issue Driving the Sentiment to Improve

Asset Views

Chinese Government Bond:

- Declining interest rates to bring bond yield down further to support the prices
- RMB hard to enter depreciation trend and remain volatile
- The current pessimistic outlook on China's economy increased the attractiveness of government bonds as the safe-haven asset

We turn to risk-on mode and prefer equities to government bonds.

Onshore A-share: Upbeat about the policy-friendly sectors, such as SOEs benefiting from valuation system with Chinese characteristics (中特估) and digital economy, high-end manufacturing sectors benefiting the requirement of technological self-reliance.

Offshore HK stocks/ADRs: With the strong beat of Q1 estimate, recovering earnings expectations, supportive stance to promote the private economy development, the Chinese tech sectors have robust fundamental. Once the sentiment picks up, the valuation pressure could alleviate, and we are optimistic about the Hang Seng TECH Index

Relevant Index

ICBC CSOP FTSE Chinese Government Bond Index

ICBC CSOP FTSE Chinese Government and Policy Bank Bond Index

CSOP Hang Seng TECH Index

CSOP STAR 50 Index

CSOP FTSE China A50

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