China markets: A sneeze is not a cold

The MSCI China and SSE50 corrected by about 4.1% and 4.4% respectively over Thursday and Friday, of the week ended 8 March 2019.

The market declines were triggered by the following events.

- Overnight reaction to US markets which saw a correction in the S&P500 facing resistance at the 2800 level
- Weaker than expected China economic data including exports and credit growth for February 2019
- Citic Securities downgrade on People’s Insurance Company of China (PICC), the nation’s largest state-owned insurance stock, in a sign that the Chinese government wants to slow down rallies

These declines occurred within an overall market uptrend with indexes that are up nearly 20% year-to-date, buoyed by positive drivers. The positives outweigh the risks, looking to several developments over the horizon. This includes a US-China trade deal that would relieve significant pressure and uncertainty on the market, in addition to projected economic recovery in the second half of 2019. From a deleveraging campaign in 2018, China has turned to a policy easing mode for 2019. Policymakers announced two reserve requirement ratio (RRR) cuts earlier this year, a value-added tax (VAT) cut during the 2019 National People’s Congress, raised local government special bond issuance quotas, income tax cuts and potentially more details of auto and home appliance subsidy stimulus outlined after their initial announcement earlier in the year. Although credit growth data for February 2019 was weaker than consensus expectations, it should be taken in the context of comparatively strong numbers in January 2019.

Despite the volatility, China’s capital markets remain attractive to foreign investors, evidenced by a rise in its index representation. MSCI’s decision to quadruple China ‘A’ share weight within global benchmarks by November 2019 will potentially usher in US$70 billion of inflows, and the figure is likely to grow in future years as the index representation rises further.

Since much of global emerging market funds are still generally underweight on China, the increase in index weighting could trigger sustained inflows. The appreciation of the renminbi in 2019 is also another positive surprise which, outside of the export sector, should translate favourably to Chinese corporate earnings. The stronger currency also gives the People’s Central Bank of China additional monetary flexibility.

From a valuations perspective, China equity markets are still below their 15-year historical mean on a price-to-earnings ratio and price-to-book ratio (for MSCI China and HSCEI), and well below the 10-year historical mean for ‘A’ shares (SSE50 and CSI300). Hence equities are not too expensive or overbought despite outperforming global markets year-to-date.

House view and positioning

The challenge for investors is a difficult patch of poor economic data and corporate earnings results in 1Q2019 that could extend to 2Q2019, and whether the upward trajectory for US markets can be sustained. Any risks to a full trade resolution between the US and China also remains. However, in summary, the positives outweigh the risks at this point, so we remain on an overweight position in China.

Important Notice & Disclaimers

UOB Asset Management Ltd Co. Reg. No. 198600120Z

To find out more,
please visit www.uobam.com.sg

RIGHT BY YOU