China Allocation Opportunity

As of August 30, 2024, monthly performance commentary and review

Performance Review

The fund returned positively for the month of August. MSCI China gained 1.0% while MSCI China A onshore (in USD terms) was down 1.9 %. Hang Seng High dividend returned 3.51%. JACI China investment grade bonds ticked up 1.4% and JACI China high yield bonds slipped 0.2%. Barclays China Agg (in USD terms) was up 2.0%.

Fixed income contributed the most to performance this month followed by equities. Tactical asset allocation was positive this month, with top contributors being our allocation in offshore over onshore equities, our instrument selection within offshore equities and preference for credit were additive as well. This was offset slightly by our long dollar position vs. Renminbi (RMB) and allocation to China government bonds. Our underlying equity manager underperformed its own benchmark in August, driven by detractions from stock selection in healthcare and communication services, which was partially offset by contributions from stock selection in consumer staples. Our underlying fixed income manager underperformed in both high yield and investment grade sleeves against their own respective benchmarks. Detractions in the high yield bucket were driven by the underweight in real estate, quasi-sovereign and financial, partially offset by the overweight in consumer, diversified and underweight in industrial. Within the investment grade sleeve, the underweight in quasi-sovereign and oil and gas, together with the overweight in Technology, Media and Telecommunications (TMT), detracted from overall performance. This was slightly offset by the position contributions from overweight in real estate and diversified. In terms of onshore rates selection, the performance of our underlying manager was relatively flat to its benchmark.

Market Review

Market performance through August has been solid across most asset classes, but this masked notable volatility within the month. At the beginning of the month, a sharp sell-off across global equity markets was triggered by the disappointing US labor market data and the BOJ rate hikes. Falling US yields weighed on the US dollar and triggered an unwind of popular carry trades. In particular short positions in the Japanese yen were reduced, driving USDJPY below 145 for the first time since January. As a consequence, Japanese stocks experienced one of their worst days in history.

However, the global stocks quickly recovered their prior losses and reached new all-time highs in the following week. Interest rates stayed around year-to-date lows as falling inflation and slowing growth suggest faster policy rate cuts than previously anticipated, especially in the US. The US dollar depreciated against all other G-10 currencies and dropped towards a 12-month low in August, but stabilized somewhat at month-end. The gold price has been rising for the 7th consecutive month, reached a new all-time high above USD 2’500.

Headline Chinese equities posted slight positive returns, but trailed behind the Asian emerging market amid a string of weak economic data released and geopolitical concerns approaching the US election. Chinese equity market held up better relative to peers at the beginning of the month while the global markets sold off on the disappointing US jobs data and unwinding of crowded yen trade. However, the volatility spiked up and dragged down the Chinese equity market as we entered the earnings season in the second half of August. Notably, offshore high dividend equity and investment grade (IG) credits outperformed. China is still a source of disappointment on macro front. July activity data suggests more downside risks to the government's annual GDP growth target of 5%. Fixed asset investment eased (1.9% vs. 3.6% in June), showing moderation in both manufacturing and infrastructure, along with ongoing weakness in property investment (falling 10.8% vs a year ago). Retail sales beat consensus marginally (2.7% vs 2.6% est) and improved from its very low level in June. The unemployment rate inched up to 5.2%. Total social financing data also missed expectations, suggesting that weak household and corporate credit demand has yet to see signs of a turnaround.

Outlook & Strategy

In contrast with sluggish economic data and weak activity in July, potential stimulus are on the way, including using CNH 300bn government funding to support the upgrade of corporate equipment and home furniture, and reducing rates on outstanding mortgages. While we think the direction of demand-side easing would lift sentiments, the probability of a meaningful turnaround is still low in the near-term.

On the back of a cooling US labor market, slower inflation and dovish signals from the Fed, the US 2-year yield dropped nearly 40 basis points (bps) in short order, trading below 4% for the first time in over a year. Falling US yields and the BoJ rate hike weighed on the US dollar and drove CNH to appreciate ~2% over the month. At the same time, PBoC's yuan fixing has come to a year-to-date high, as latest exports came in weaker than expected and there has been less pressure in CNH amid the dollar selloff. We think soft economic fundamentals, ongoing monetary easing and the US election is likely to drive USD/CNY back higher, with the short positions looking more balanced after the carry unwinds.

In terms of cross-asset positioning, we trimmed our equity risk exposure further and maintained a full exposure towards fixed income in anticipation of higher volatility amid policy and geopolitical uncertainty as we move closer to US election.

Within equities, we continued to have conviction in artificial intelligence (AI) and high income themes and adjusted our sector exposures to reduce equity risk and increase diversification moderately by rotating the broader tech exposure to more AI-focused exposure. To evolve the AI thematic play, we dived deeper into the concept and decided to focus on and added to our position in AI-beneficiaries across up-, mid-, and downstream, particularly industry players powering the whole AI supply chain to broaden our existing AI thematic exposures. Apart from our AI theme, one observation we have made recently is that there seems to be some sense of rationality returning to the market with investors being more willing to differentiate between companies with resilient and even improving fundamentals and those that continue to struggle in the challenging macro backdrop. To this end, we saw some green shoots in the China Internet sector where earnings revision and price momentum has turned more positive. On the back of this incremental market development, we initiated a small position in China Internet, funded out of existing equity exposure.

Within fixed income, we remain constructive on China high yield (HY) in August, recognizing that sharp and broad-based market rallies hereon are likely led by property, and see HY as a better way to capture this relative to property equities. We had a reasonable exposure to government bonds for diversification benefits.

In FX, we retain our short CNHUSD position, fully hedging onshore government bonds exposure.

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