China Allocation Opportunity

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

Performance Review

The strategy returned negatively for the month of October. Chinese equities ended in a negative territory after the market correction after the golden-week holiday. MSCI China slipped 5.9% while MSCI China A onshore (in United States Dollar (USD) terms) was down 2.8%. Hang Seng Tech fell 5.3%. Onshore small cap outperformed (CSI 1000 +5.6%), supported by pick-up of retail investors' interest. JACI China investment grade bonds were muted at -0.8% and JACI China high yield bonds ticked up 1.9%. Barclays China Agg (in USD terms) slipped 1.3%.

Equities dragged down the performance the most this month, slightly offset by fixed income. Tactical asset allocation was negative this month, with key detractors being our absolute allocation in equities, in particular our offshore allocation. This was slightly offset by short position in CNH against strengthened USD, together with the onshore position and preference on high yield.

Our underlying equity manager underperformed its own benchmark in October, driven by overweight in consumer staples and communication services. This were partially offset by contributions from stock selection in consumer discretionary and health care, along with underweight in consumer discretionary.

Our underlying high yield credit manager outperformed against its own respective benchmark. Key contributions in the high yield bucket were driven by the issue selection in real estate and sovereign, as well as overweight in Technology, Media and Telecommunications (TMT), partially offset by the overweight in consumer and financial, together with underweight in quasi-sovereign. Our underlying investment grade credit manager underperformed against its own respective benchmark, with the key detractors being the overweight in financial and industrial. This was partially offset by the positive contributions from underweight in quasi-sovereign and utilities, along with the overweight in TMT. In terms of onshore rates selection, our underlying manager outperformed its own benchmark in October.

Market Review

Primary property sales and manufacturing Purchasing Managers' Index (PMI) post the first rebound in October after policy support this year. Amid the volatility intensified by golden week, disappointment on fiscal support, and anticipation of a Red sweep, Chinese equities corrected from the unprecedented rally in September.

The primary property sales in China recently turned positive year on year (YoY) for the first time in a while, led by tier 1 cities where easing measures were announced. Magnitude was larger than other rebounds after policy supports this year but smaller than the post reopening surge. National Bureau of Statistics (NBS) and Caixin manufacturing PMI also rose above 50 for the first time since March. Sustainability of the rebound bears watching.

In China, when the markets re-opened after "Golden week" holidays, equities corrected from the unprecedented rally in September. A meeting by the Chinese National Development and Reform Commission (NDRC) did not bring any new details on potential fiscal support, causing some disappointment among investors. China consumer spending over the "Golden Week holiday" was relatively subdued, underscoring the need for government stimulus. Tourism spending per capita was slightly below the pre-covid level, highlighting still weak domestic demand and continued consumption downgrading.

Outlook & Strategy

The news conference held by Ministry of Finance was in line with expectations. While there was no specific number for the fiscal package and no reference on the consumption support reported by Reuters, the upside lied in the forward guidance. The Ministry of Finance (MoF) emphasized several times that the final number will be “relatively large”, with “quite large room to increase deficit” and “the largest in recent years to support local governments debt issue”, and “we are studying other policy tools”, after reporters pressed for more clarity on the size. This reinforced that policymakers’ determination has not changed.

However, National People’s Congress (NPC) confirmed that policymakers are focused on delivering a stabilization package rather than a stimulus package, and their approach for now remains more reactive than preemptive. Market reactions after the Red Sweep and the NPC miss, in early November, have been relatively contained, suggesting that investors, especially onshore investors, might have already adjusted expectations and are looking forward to the December Central Economic Work Conference (CEWC).

The Red Sweep is associated with tax cuts and additional trade tariffs, though, the timing and size of the tariff remains uncertain. Given that China still has fiscal space amid increased fiscal spending, investors have been in the hopes that policy support in the immediate future will be strong enough to smooth any potential setback.

We maintained the view that China’s policymakers remain serious about cutting off the left tail to growth and positioning has become cleaner after recent pullbacks, but at the same time we recognized challenges with coordination and execution of fiscal measures over the near-term. Additionally, the Red Sweep would be a headwind to Chinese equities.

In terms of cross-asset positioning, while we kept our risk on stance, underpinned by the pivot of government policy, we took profit and trimmed some equity exposures ahead of MoF, in mid-October, for risk management and maintained our preference in equity over credit.

Within equities, since the start of the year, we have been favoring offshore shares over onshore, given the former is more linked to global investment sentiment, until recent stimulus announcement where we turned more positive towards latter as the announcement is likely to provide more tailwind to domestic shares. Approaching US election, we further shifted more offshore broad market exposure to onshore thematic plays, including China Internet, China brokers, High dividend ex-banks, and diversified Artificial Intelligence (AI), that are more insulated from geopolitical risk. We topped up the position and recalibrated expression of our high income theme, partially allocated to a Hong Kong Shareholder Return basket, which is the key benefactor to State-Owned-Enterprises (SOE) reform and policy maker focus on enhancing shareholder return. We also recalibrated the allocation among the AI baskets with a focus towards onshore and ensured the thematic basket is diversified across supply chain such as core AI, manufacturing, software and resources. We closed the remaining non-China exposures and rotated to China onshore. Overall, we held a relatively balanced allocation between onshore and offshore shares.

Within fixed income, We trimmed overall fixed income exposure across credits to fund the China onshore exposure. We maintained a decent exposure to onshore rates for portfolio construction purpose.
In Foreign Exchange (FX), we retain our short CNHUSD position, fully hedging onshore government bonds exposure. We initiated short KRW position as a hedge ahead of US elections.

Additionally, we further added position in gold as part of the hedge bucket alongside duration considering geopolitical risk escalation potential.

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