Market volatility in China

China in March

In February, Chinese equities were ranged bound in the first half of the month before the Russia-Ukraine war shook the world and pushed commodity prices and volatility in global equities to much higher levels.

The onshore A-share market demonstrated better resilience than its offshore counterpart, with the MSCI China A Onshore index returning 2.8% while the MSCI China index was down 3.9%.

Heightened volatility of the Chinese equity markets

Volatility of Chinese equities has increased considerably over recent weeks due to several domestic and external events that hit the market simultaneously.

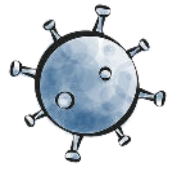
Domestically, a resurgence of COVID-19 cases has led to local lockdowns in multiple cities including Shanghai and Shenzhen.

The real estate sector has slowed further with more defaults among developers, weighing on the recovery of the job market and the economy.

Additionally, media reports on the cybersecurity probe at Didi (a ride-hailing provider) and Tencent's violation of anti-money laundering raised concerns about a fresh wave of regulatory crackdowns on the internet sector.

Overseas, China is navigating geopolitical tensions carefully around the Russia-Ukraine war, while the delisting threat on Chinese ADRs re-escalated as the US Securities and Exchange Commission released the first provisional batch of companies that could be impacted.

Central bank tightening in the developed nations and inflation concerns also did not help. During the first 11 trading days of March, the MSCI China and MSCI China A Onshore indices were down 24.9% and 14.2% respectively , cementing one of the worst-performing periods in the history of Chinese equities.



COVID-19 resurgence leads to Shaghai and Shenzen lockdown

24.9%

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To RisCura, the sell-off was and is overdone, and it has little to do with valuations and fundamentals, but rather with sentiment. While geopolitics is a wild card, most of the other risk factors were well-telegraphed and understood by domestic asset managers, and we have already seen some positive signs for each of them **(please let us know if you are interested to hear our thoughts on any of the issues in more detail).**

At the same time, retail investors were panic-selling and foreign capital also rushed out – as an indicator of foreign capital flows, StockConnect's northbound trading (trading in mainland securities by offshore investors) had eight consecutive days of large net outflows. At present, the valuations of many Hong Kong stocks and Chinese ADRs are at an extremely low level. Taking the internet sector as an example, the top five Chinese companies – Tencent, Alibaba, Meituan, JD and NetEase, at the low point had a combined market cap of $800 billion, which is less than half of the market cap of Amazon.

Historically, there have been multiple times when foreign investors asked the question of whether China is investable. Each time China eventually pulled through, delivered strong growth and regained investor confidence.

Although volatility may persist in the near term, we remain constructive on Chinese equities given the cheap valuations and strong policy support. We have noticed clients making use of the recent weakness in Chinese equities to top up their allocations at levels that we expect will turn out to be very attractive valuations.

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The subsequent strong rebound in the market suggests that we are probably close to the bottom. The MSCI China Index rallied by more than 22% in two days after Chinese policymakers addressed many of the key market concerns. These included signalling the end of the tech sector regulation, support for the stock market such as asserting confidence that they can resolve the required transparency by US regulators of Chinese companies listed on the Nasdaq.

This was also strategically timed to coincide with the tightening policy of the US Fed demonstrating that China has far more room to provide easy monetary policy at a time when developed markets are tightening.

$800bn

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22%

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The managers we work with are actively managing risks in their portfolios and taking advantage of the market volatility to rebalance and put capital to work, adding to existing names where they have a strong conviction, and initiating new positions at attractive prices.

This gives us comfort that our clients' money is in safe hands with managers who have the courage and experience to navigate through challenging times.

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