CIO Perspectives

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Hou Wey Fook, CFA
Chief Investment Officer

Yeang Cheng Ling
Strategist

Key Points

- China policymakers have been addressing market overhangs and are working to resolve the situation. Thus, we expect markets to recover.
- Progress is being made on the Covid situation, platform e-commerce and technology regulation, and ADR delisting issue.
- Institutional underweight of China equities relative to benchmark is at a 10Y low. Absolute and relative valuations of China equities are also at multi-year lows.
- We see asymmetric risk-reward in favour of being invested, on the back of returning to normalcy, progress in removing the market overhangs, and compelling valuations.
- Sectors we prefer are China large SOE banks, platform e-commerce, technology, and insurance companies.

GLOBAL CROSS ASSETS
Returns of cross assets around the world

Index	Close	Overnight	YTD
DJIA	32,654.59	1.3%	-10.1%
S&P 500	4,088.85	2.0%	-14.2%
NASDAQ	11,984.52	2.8%	-23.4%
Stoxx Europe 600	438.97	1.2%	-10.0%
DAX	14,185.94	1.6%	-10.7%
CAC 40	6,430.19	1.3%	-10.1%
FTSE 100	7,518.35	0.7%	1.8%
MSCI AxJ	658.82	2.6%	-16.5%
Nikkei 225	26,659.75	0.4%	-7.4%
SHCOMP	3,093.70	0.6%	-15.0%
Hang Seng	20,602.52	3.3%	-11.9%
MSCI EM	1,030.83	2.3%	-16.3%
UST 10-yr yield*	2.99	10.4	147.6
JGB 10-yr yield*	0.24	0.1	17.6
Bund 10-yr yield*	1.04	10.9	122.6
US HY spread*	4.48	-11.0	165.0
EM spread*	401.68	-6.8	71.4
WTI (USD)	112.40	-1.6%	49.4%
LMEX	4,483.90	1.4%	-0.4%
Gold (USD)	1,815.16	-0.5%	-0.8%

Source: Bloomberg
* Changes in basis points

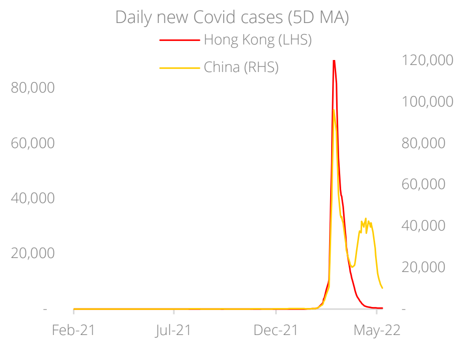
EQUITY STRATEGY

China – Stay Overweight

China has been addressing market overhangs such as the Covid situation, China real estate developers, platform e-commerce and technology regulations, and American depositary receipt (ADR) delisting issue. We maintain the view that the market will find a bottom at current levels to stage a long-awaited recovery as policymakers have been proactively introducing supportive measures and working to resolve the situation.

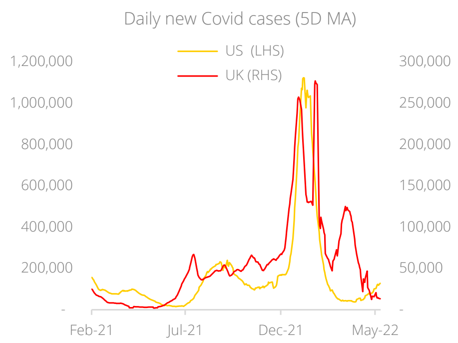
Covid cases are falling and should further subside in due course. While there has been headline news on lockdowns and the impact on the economy, the actual number of Covid cases in China is falling (Figure 1), paving the way for reopening. Drawing from the experience in the US and UK, the current Covid outbreaks in various parts of China should eventually subside to pre-omicron levels. In the US and UK, it took approximately six weeks to peak and six weeks to fully subside (Figure 2). If China and Hong Kong follow the same pattern, daily new cases should return to low levels in China towards summer.

Figure 1: Daily new cases in China and Hong Kong



Source: Bloomberg, DBS

Figure 2: Daily new cases in the US and UK



Source: Bloomberg, DBS

Covid impact on EPS being factored in. Consensus on earnings per share (EPS) downward revisions have been largely priced in (Figure 3).

Figure 3: EPS downward revisions have been largely priced in

Source: Bloomberg, DBS

China property market supportive policies. Various local governments have relaxed limitations on property purchases, and banks have lowered borrowing costs for mortgages. Further tightening measures seem unlikely while gradual support to the property market is being administered at a measured pace.

Platform e-commerce and technology. New government regulations continue to be introduced at a faster pace as promised and on a stable and transparent basis. The markets are looking forward to clarity and the end of further tightening.

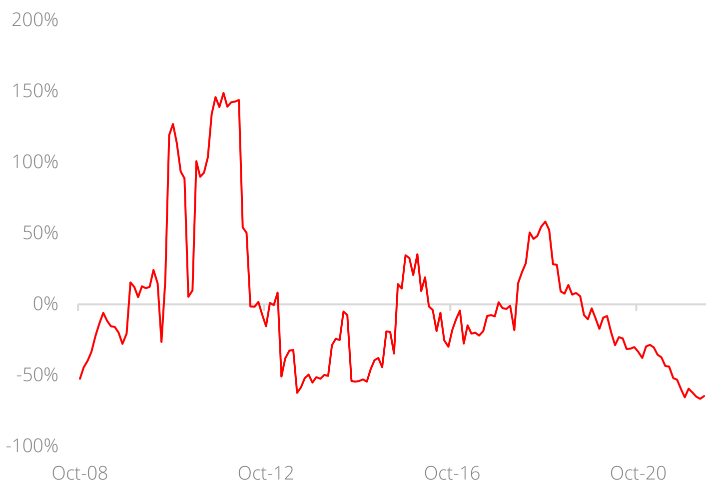
ADR delisting issue. China regulators are considering allowing the US Public Company Accounting Oversight Board to conduct joint inspections with Chinese regulators on Chinese ADR companies' auditors. Should this transpire, it may resolve the issue.

Institutional holdings at 10Y low. Global equity funds have greatly underweighted China relative to benchmark weight for the most part of the past 10 years, and aggressively reduced the weights since 4Q18. Currently, the benchmark-relative underweight in China is at 10Y low (Figure 4).

China equities at historical trough valuations. China's forward PER (price earnings ratio) has dropped to below historical mean while the P/B ratio is below -1 standard deviation, both at the lowest in seven years (Figure 5, 6). Such compelling valuations are adding to the support against downside risk. On a relative basis, China equities are trading at a steep discount to global average (Figure 7).

Risk-reward in favour of being invested. A lot of pessimism has been priced in and expectations set low. On an absolute and relative basis, China equities are inexpensive and being underweighted. We see asymmetric risk-reward in favour of staying invested, on the back of returning to normalcy, progress in removing the market overhangs, and compelling valuations. Sectors we prefer are China large state-owned enterprise banks for their stable yields of 6-7%, platform e-commerce, technology firms, and insurance companies that ride on long-term secular growth trends.

Figure 4: Global equity funds' allocation to China's relative benchmark* (%)



Source: EPFR Global, DBS
*Using ETF weights as proxy

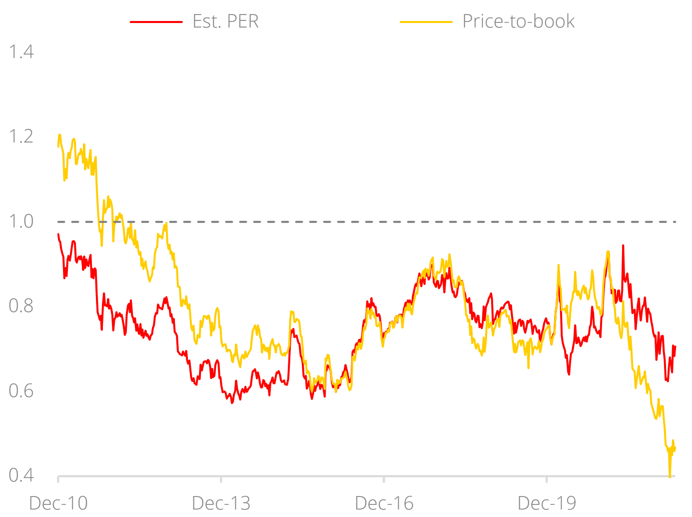
Figure 5: Forward PER below historical mean

Source: Bloomberg, DBS

Figure 6: P/B at deep value

Source: Bloomberg, DBS

Figure 7: China equities valuations relative to global average



Source: Bloomberg, DBS

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