China Insights

China's Nasdaq moves into the mainstream August 2020

Summary

- Capital raised on China's Nasdaq-styled STAR market so far in 2020 has surpassed the amount raised on the two main boards in Shanghai and Shenzhen combined, making it a competitive listing venue
- There are significant differences between the current market conditions and those in 2015, reinforcing our positive view on the long-term prospect for the domestic market
- On a cautious note, we note that the benchmark rates for 1-year and 5-year were unchanged for the third consecutive month, suggesting a less aggressive easing stance

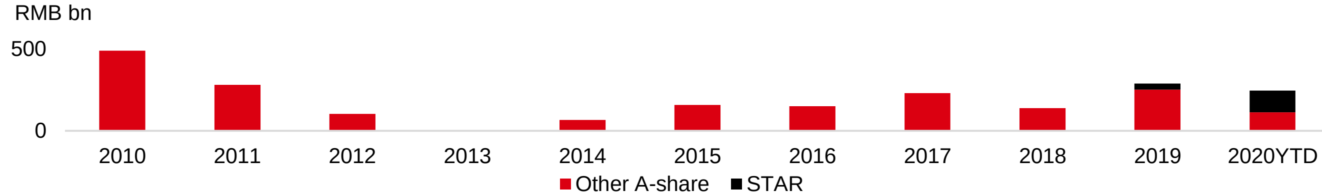
China's Nasdaq moves into the mainstream

Exactly a year since its launch, the STAR market has taken center stage with more companies choosing to raise capital on China's Nasdaq-styled listing bourse amidst the country's drive to secure strategic technologies domestically.

Capital raised on the STAR market so far in 2020 has surpassed the amount raised on the two main boards in Shanghai and Shenzhen combined, making it a competitive listing venue. According to public data, the STAR board raised RMB133 billion of capital so far this year, compared with RMB113 billion raised in the two bourses. Meanwhile, a strong secondary performance in the STAR market has helped build a solid IPO pipeline. Data from Bloomberg shows 67 companies on the STAR board surged 198% on average since their market debut. That's primarily driven by technology and consumer cyclicals, which have surged 226% and 195%, respectively.

The tech-focused listing venue in Shanghai is now set to go mainstream after a major fintech company, backed by the country's largest e-commerce giant, announced plans to list its shares on both the STAR market and the Hong Kong stock exchange. According to media reports, the IPO hopeful, the parent company of the world's largest money-market fund, plans to raise USD20 billion, valuing the firm at USD200 billion in market cap.

Volume of IPOs - STAR surpasses other domestic listing venues



Source: WIND, HSBC Global Asset Management, July 2020.

HSBC Global Asset Management

China's Nasdaq moves into the mainstream (cont'd.)

The largest deal so far for STAR is the USD7.5 billion listing of a Chinese chipmaker, whose shares rose 187% since its July debut. The share sale of the chipmaker comes after it decided to delist from New York last year amid the US-China trade disputes and increasing scrutiny over technology and strategic industries, such as semiconductors and video-streaming platforms. As US-China conflicts are likely to continue ahead of the US presidential election in November, a number of Chinese companies in industries including technology, healthcare and automobiles, have announced their plans to raise capital in STAR market, thanks its more favourable vetting process.

The STAR Board allows pre-profit companies to raise capital more swiftly than the traditional funding routes since many of these pre-profit or loss-making startups do not fit the listing requirements of the main board in Shanghai and Shenzhen nor are they eligible for bank loans given their short track records.

Another supportive factor is the willingness of onshore investors to pay a premium for growth stocks. For instance, the onshore listed shares of the aforementioned chipmaker is trading at a 190% premium over its Hong Kong-listed shares. On the whole A-shares are trading at a 59% premium over their H-share counterparts on a market-cap adjusted basis.

Mindfulness at work

China A shares, represented by the CSI 300 Index of the country's largest companies, have rallied 36% since their trough in March on the back of a revival in a slew of economic data triggering worries over a potential market bubble.

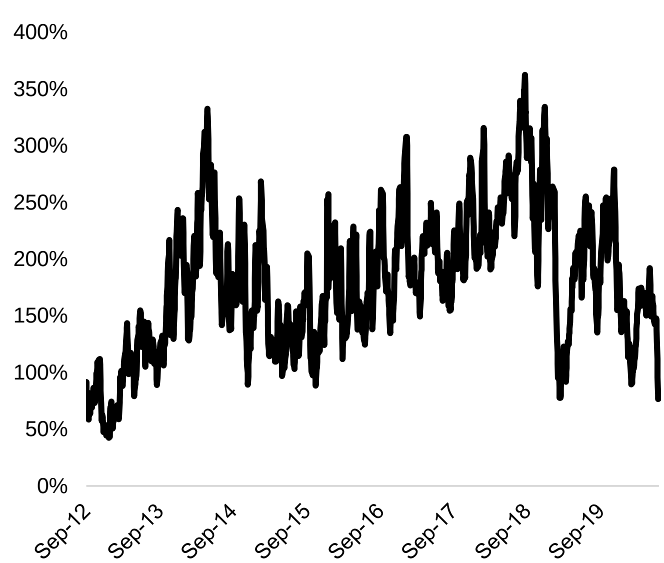
Retail sentiment has pick up significantly since March, but the rally is not comparable to the one witnessed in 2015, when stock prices surged early in the year and came crashing down in the summer months. The average daily turnover of the margin balance reached RMB1.3 trillion in July, up from RMB1 trillion earlier this year but below the RMB2.2 trillion level seen during the frenzied purchasing in the summer of 2015. Meanwhile, margin financing to total turnover has been declining over the past month, suggesting the recent hype might have cooled and investors have learned from the events of 2015.

Overall, the margin financing ratio is still at a rational and healthy level when compared with 2015 and valuations of China A-shares are still hovering around 10 years lows relative to MSCI China, reinforcing our bullish view on China A companies on a selective basis.

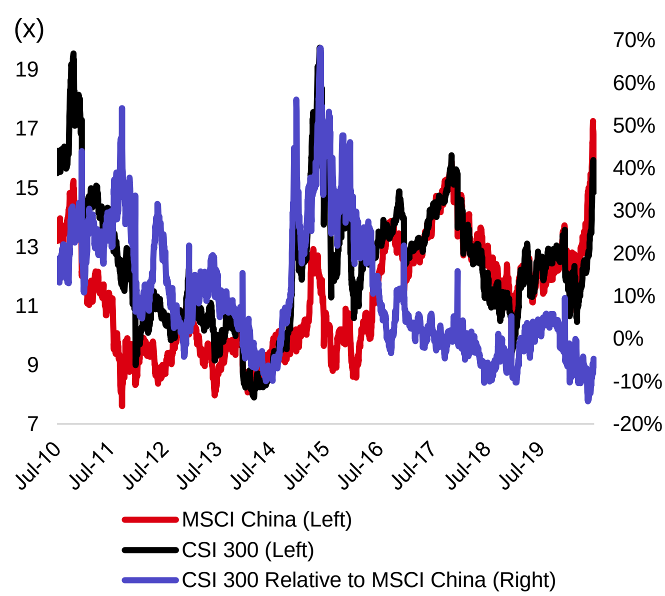
On a cautious note, we have observed that the July LPRs – the benchmark rates – for 1-year and 5-year were unchanged for the third consecutive month, suggesting that policymakers may have adopted a less accommodative stance on monetary easing. However, we don't see a major shift in policy direction until employment conditions improve materially.

Looking forward, companies that offer low valuations and stable earnings are attractive, in our view. Rising risk appetite and ample liquidity are still core drivers for the market. A generally more upbeat sentiment towards the ongoing economic recovery in China could lead the risk appetite to pick up further in the short term.

Margin Financing as a % of Turnover (5 days average)



12 months forward PE MSCI China vs CSI 300



Source: Morgan Stanley, Bloomberg, HSBC Global Asset Management, data as of July 2020.

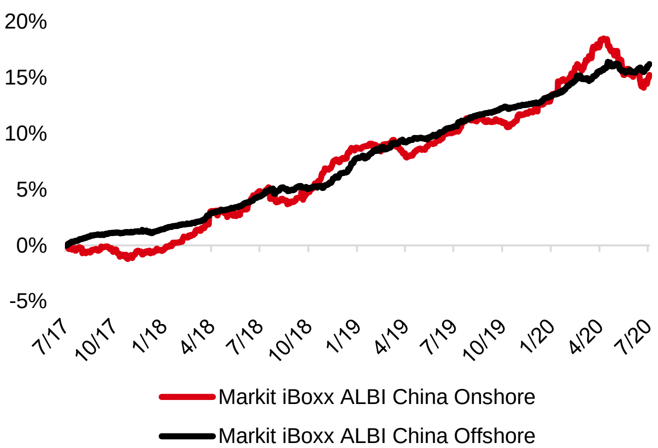
In the following pages we will take a deeper look at how recent events and policy measures are impacting Chinese fixed income and equity markets:

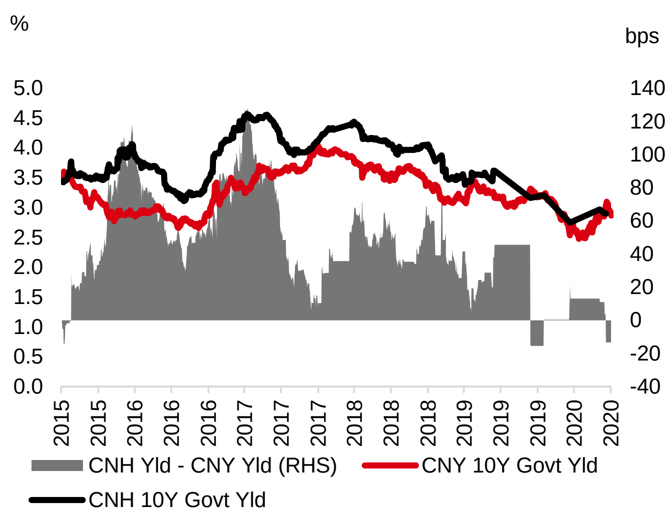
Fixed income

Net inflows into onshore bonds reached USD45 billion this year, driven by attractive bond yields in China and index allocation

- In July, the yield curve of Chinese government bonds continued to edge higher as improving risk appetite pushed investors to reposition some of those safe haven bets into the surging stock market. More broadly, rising US-China tensions and the ongoing Covid-19 pandemic continue to be major concerns for investors, triggering a rotation back into high yield bonds
- Despite an improving macro backdrop in China, the onshore RMB bonds, measured by iBoxx ALBI China Onshore Index, shed 0.3% in the month ending 24 July, bringing down the year-to-date gain to 2.2%, partly reflecting rotation into the stock markets from bonds and concerns over the continuation of easing efforts after a stronger rebound in economic activity. There are expectations that the PBoC may take a softer stance on monetary easing, in a move to avoid systematic risk in the banking system and risks of bubbles in the property sector
- On a brighter note, the offshore gauge, the iBoxx ALBI China Offshore Index, added 0.5% for the same period. In the offshore China dollar credit market, investors continued to prefer risky assets, with high-yield bonds rising 1.8% over the month, even though the US dollar has weakened since its March peak. The investment grade universe added 1.4% in July
- The dollar index tumbled in the month, as negative real rates in the US, the ongoing spread of coronavirus in the world's largest economy and a pick up in risk appetite globally have pushed investors to sell the greenback. With the dollar index already down 3% in July, the yield on five-year Treasuries dropped to its all-time low at 0.255% on July 24, underscoring concerns over the prospect of its recovery
- In terms of fund flows, China bond market received robust net inflows in June, largely driven by government bonds and widening interest rate differential between China and developed markets. Net inflows into onshore bonds was USD12 billion in June, slightly below the record inflow of USD16 billion in May, but remains above the average monthly inflows of USD7 billion since the second half of 2017
- Central government bonds and policy bank notes each received USD6 billion in inflows, while negotiable certificates of deposit saw USD1 billion of outflow. On a year to date basis, net bond inflows reached USD45 billion

Chinese bonds remain steady amidst new rounds of global easing





Source: Bloomberg, Markit data as of 24 July 2020. Total return in local currency terms.
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Equity market

> Excluding banks, the offshore and onshore index are trading at 18.2x and 17.5x, respectively mainly due to richly valued companies in healthcare, consumer and information technology sector

- Both onshore and offshore Chinese equities extended their rally in July, as the sentiment boost from upbeat second quarter GDP growth boosted hopes for earnings improvement. The Chinese economy expanded 3.2% year on year in the second quarter, better than 2.5% forecast by economists and followed by a 6.8% contraction in the first three months. According to latest consensus forecast, economists expect the economy to expand 4%-6% in the third and fourth quarter, depending on how Beijing grapples with the pandemic and ongoing tensions with the US over technology, trade and diplomatic issues

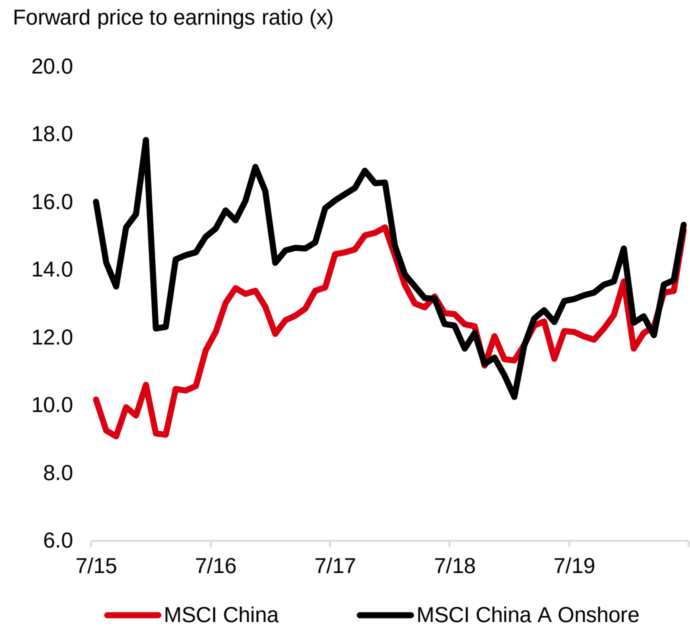
- On a month-to-date basis (24 July), MSCI China A Onshore and MSCI China gained 7.9% and 7.0%, respectively. Locally the CSI 300 Index of the country's largest companies added 9.7% in US dollar terms, while the Hang Seng Index added 1.1%.Tech-heavy ADRs gained 10.1% in the month, driven by the prospect of growing number of Hong Kong listings by those US-listed Chinese technology companies. The ChiNext index, the gauge of small-cap tech stocks, advanced 7.8% for the month

- Given a rising interest in technology shares, a benchmark index for the STAR Board – the Nasdaq-styled tech board in Shanghai – was launched after July 22 market close and Hang Seng Index will launch a new tech index on July 27

- In terms of fund flows (as of 24 July), the southbound trade through the Stock Connect has recorded USD48 billion of net buying so far this year, while the northbound trade has seen USD19 billion of net purchases for the same period after having a USD3.5 billion outflow in the week of July 20 due to heighted tensions between the US and China

- After a rally in the second quarter, the valuation of Chinese stocks has become loftier with MSCI China and CSI 300 trading at 14.6x and 13.7x of 12-month forward earnings. Excluding banks, the offshore and onshore index are trading at 18.2x and 17.5x, mainly due to richly valued companies in healthcare, consumer and information technology sector

Chinese stocks rally amidst global volatility



Source: Bloomberg, HSBC Global Asset Management, as of 24 July 2020. Total return in local currency terms.

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Sector*	Outlook	Comment
Consumer Discretionary	+	In particular, we like the education space as it is relatively less sensitive to macro headwinds. Amidst the domestic consumption recovery, we prefer local brand names with strong online sales channel and low inventory levels, such as sportswear companies. We added some local hotel and travel agent names as elimination of overseas travel will boost local travel.
Consumer Staples	+	Margin expansion capability of select strong staple brand names remains considerable supported by higher pricing power and utilising the ecommerce channel. Demand should recover quickly after COVID-19 outbreak, especially for alcoholic beverages, with policy support measures like "consumption coupons".
Energy	-	Oil price has dropped amidst a sharp decline in demand due to lockdowns and travel bans during global coronavirus outbreak, which we believe will take a long time to recover
Financials	-	Despite a short term pick up in value stocks, we are underweight banks as lowered rates may add pressure to their net interest margins. We prefer high quality insurance companies with long term growth opportunities at attractive valuation.
Healthcare	+	We favour those with strong R&D capabilities in innovative drugs and service providers with high growth visibility and solid business models
Industrials	-	More infrastructure projects to boost economy and full resumption of construction works are on the horizon but the focus will be on "New Infrastructure" instead
Information Technology	+	We are positive on the handset lens upgrade trend and we like names that can benefit from continuous tech upgrade as smartphone demand remains stable despite the coronavirus outbreak
Materials	O	Demand for building and industrial materials have been impacted by heavy rainfall and flood and we question the sustainability of the demand given the global economic slowdown. We prefer gold mining companies within the sector given the surge in gold price
Real Estate	O	We are turning positive on property names as their funding cost pressure will be relieved by a loose monetary policy. We prefer property management companies from the longer term perspective as a defensive business with ongoing market consolidation.
Communication Services	-	We selectively prefer gaming, social platform and cloud services companies as coronavirus outbreak will speed up technology adoption. We are underweight telecom names due to the lack of catalysts.
Utilities	-	We are not positioned defensively in the current market

Source: Bloomberg, HSBC Global Asset Management, as of July 2020.
*NOTE - Sector views of HSBC Global Asset Management's offshore Chinese equity team; "+" = positive, "–" = negative, "O" = neutral
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Data watch

Indicator	Date	Actual	Consensus	Prior	Analysis
Industrial production (IP) (yoy)	Jun	+4.8%	4.8%	4.4%	China's Q2 real GDP returned to a positive YoY growth of 3.2% after dropping 6.8% in Q1. On a sequential basis, the economy rebounded strongly by 11.5% qoq (sa) following Q1's 10.0% contraction, amid policy stimulus, pent-up demand, and normalisation of production activities. The recovery was led by growth in the manufacturing and construction industry. Services/tertiary industry activities also improved despite divergences among sectors, with IT and financial services continuing robust growth and accommodation & catering services contracting 18% yoy in Q2 (vs. -35.3% in Q1). Meanwhile, June activity indicators showed a continued yet uneven growth recovery. Improving consumer demand, strong infrastructure investment, resilient property activities and better-than-expected exports underpinned IP. We expect a cyclical recovery to continue, as the laggard sectors continue to normalise and consumption should further pick up gradually, provided no significant resurgence of COVID-19 in China. That said, after a sharp rebound in Q2, the sequential pace of growth recovery is likely to slow notably in H2 and economic activities have not fully returned to normal yet. Uncertainties over the macro outlook remain high related to the temporary impact from the recent flood in Southern China , domestic consumption amid weakened labour income prospects, still-fragile global demand, and geopolitical tensions. We do not expect a reversal in the accommodative macro policy stance in the near term, though better economic data may have reduced the government's incentive to ramp up stronger policy stimulus. Fiscal policy should remain proactive to sustain the recovery, while monetary policy is likely to be data dependant and focused on targeted credit/liquidity support for the real economy.
Fixed Asset Investment (FAI) (ytd, yoy)	Jun	-3.1%	-3.3%	-6.3%	Infrastructure FAI maintained a robust momentum on easier funding conditions and policy support. Manufacturing capex also continued to improve though the recovery lagged amid subdued industrial profits and uncertain demand outlook. Property sector data, such as real estate FAI, new housing starts, home sales, land purchases and developers' sourcing of funding, continued to show the sector's resilience. In July, several cities with signs of notable property price gains (e.g. Shenzhen, Hangzhou and Ningbo) have announced new rules to cool down local property markets. CIBRC is closely monitoring bank lending to the property sector and trust financing. That said, divergence is significant across cities, regions within the same city, and markets, and thus we expect more differentiated policy execution ahead to ensure stable and sustainable developments; top-down policy shift is still unlikely.
Retail Sales (yoy)	Jun	-1.8%	0.5%	-2.8%	June saw continued strong online goods sales (+14.3% yoy in H1 2020) as well as a pickup in catering services (albeit still posting a double-digit YoY fall) and housing-related items. Auto sales value lost momentum but in volume terms held up. Relaxation of containment measures or cinema and tourist attractions may help normalisation of related consumption, but the consumption outlook faces headwinds from consumer behavioural caution (weighing on offline spending) and weaker job and income prospects. Labour market conditions further improved, with more people returning to work and the survey-based unemployment rate falling to 5.7% in June from 5.9% in May. However, newly increased urban employment still declined 23.5% yoy in H1. The median disposable household income per capita only rose 0.5% yoy in H2 2020 vs. a 9.0% gain in H1 2019; direct government support for household income has been limited in China's COVID-19 policy responses.
Exports (USD) (yoy)	Jun	0.5%	-2.0%	-3.3%	China's exports continued to benefit from COVID-19-related demand (e.g. medical supplies, consumer necessities, and tech products for working-from-home and online education, etc.). Production disruptions in other parts of the world allowed Chinese goods to gain global market share. While global demand may improve as the worst of the global recession seems to be behind us, uncertainties remain high over the global recovery in light of the recent resurgence in coronavirus cases and re-imposition of stricter social distancing measures in many countries. US-China tensions remain a key risk. While China has increased imports from the US notably lately (imports from US rose 11.3% yoy in June), it seems unlikely that China will be able to meet the purchase agreement in the phase 1 trade deal for this year. Meanwhile, import volumes of major industrial commodities, autos and tech intermediate goods rebounded, consistent with better domestic demand conditions.
Imports (USD) (yoy)	Jun	2.7%	-9.0%	-16.7%	
Trade Balance (USD)	Jun	46.42 bn	59.6 bn	62.93 bn	
CPI Inflation (yoy)	Jun	2.5%	2.5%	2.4%	Higher headline CPI inflation largely reflected supply cost push, as food prices rose due to supply disruptions caused by floods and wholesale market closure in Beijing attributable to the city's cluster COVID-19 outbreak. On the other hand, core CPI inflation eased to 0.9% yoy from 1.1% in May, reflecting still soft consumer demand. We think temporary supply issues should not alter the likely tend of inflation moderation in H2, particularly as services normalisation remains relatively slow. The narrower PPI deflation largely reflected improving industrial/ construction demand domestically and higher global oil/commodity prices.
PPI Inflation (yoy)	Jun	-3.0%	-3.2%	-3.7%	
Aggregate financing (AF) (RMB)	Jun	3430 bn	3050bn	3190 bn	Growth of outstanding AF rose to 12.8% yoy from 12.5% in May. RMB bank loan growth was steady at 13.2%, with solid growth in medium and long-term loans to both households and corporates. Bill financing declined MoM, possibly due to the tightened regulation on financial arbitrage via investing in structured deposits. Bond issuance moderated but remained high. The increase in banker's acceptance bills contributed to a narrower contraction in shadow banking credit items. There is a greater emphasis of targeted policy support for corporates, especially SMEs, as PBoC warned against liquidity flooding and financial stability risks.
New yuan loans (RMB)	Jun	1810 Bn	1800bn	1480 bn	

Indicates improved data on month-on-month/quarter-on-quarter/year-on-year basis

Indicates worsened data on month-on-month/quarter-on-quarter/year-on-year basis

Indicates no change in data on month-on-month/quarter-on-quarter/year-on-year basis

Source: Bloomberg, HSBC Global Asset Management, as of July 2020

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