

# UBAM – best selection China A

Quarterly Comment | Q4 2020

For Qualified Investors in Switzerland or Professional Investors or Eligible Counterparties as defined by the relevant laws.

## Market Comment

- In November, there were obvious changes of market preferences. Blue-chip stocks such as Banks and Insurance rebounded, narrowing the yield lag created this year. On the other hand, the SME board, which has been rising since the beginning of this year, saw important drawdown. The STAR board, with Bio Meds and Technology as its main components, dropped about 50% from its high. We consider this market like the one in December 2014, there is a significant price scissor between blue chip stocks, and SME and STAR board stocks.
- Price scissor continued in December, with the price of blue-chip stocks going up, and that of small cap stocks dropping. After the listing of Ant Group was delayed, the government put more attention to those Fintech companies, which resulted to the rise of traditional banking sector and the enlarging price scissor between large and small cap stocks. We believe this trend may last as foreign capital flows are accelerating, looking for stocks and companies that has stable return in the long term, which may lead to a temporary slowdown in appetite for SME board and ChiNext board.
- Markets were exhibiting similar recent trends up until the middle of the fourth quarter, when on the 9th of November encouraging phase III trial data from Pfizer Inc' s COVID-19 vaccine prompted a dramatic rotation. The rotation was pronounced globally and had significant ramifications across the risk spectrum. Moderna Inc. then followed up with their phase III trial results which illustrated a 90% efficacy rate for its vaccine. This was then followed by AstraZeneca Plc in partnership with Oxford University and the results of their phase III trial results, illustrating a 60% efficacy going up to 90% after alterations in dosage, however some irregularities prompted the company to conduct a new trial phase. Overall, the fact that three separate vaccines each with an efficacy rate above 50%, which is the minimum level required for regulatory approval, have been successful in phase III trials means the market and economies can start to look beyond the pandemic. Adding further impetus to the bullish narrative driving markets, the US Dollar remained weak throughout the quarter which was particularly supportive for EM-related assets.
- Overall within developed markets there was a cyclical impulse behind price action with small cap equities outperforming their large cap peers in most regions, whilst cyclical sectors also broadly led their defensive counterparts.
- This culminated in a very strong fourth quarter overall for the higher beta ends of the market relative to lower beta disciplines. At the world level, the MSCI World Value Index finished the fourth quarter +15.9% vs. +12.6% for the MSCI World Growth Index. The dispersion remained vast however on a full year basis with Value -0.3% vs. +34.2% for the Growth Index. Energy (+26.9%), Financials (+23.7%) and Industrials (+15.5%) led the way during the fourth quarter relative to the traditional defensive sectors; Utilities (+9.6%), Health Care (+7.0%) and Consumer Staples (+6.4%). Financials were buoyed by a steeper US yield curve with the spread between the US 10 Yr Treasury and the 2yr finishing at 0.8%, the steepest since late 2017.

Sources: UBP, Bloomberg Finance LP.



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## Performance Review

- During the fourth quarter, the strategy outperformed the MSCI China A NR. Sector allocation contributed, further enhanced by a strong stock selection.
- Overall 2020 was a very good year for China A and for the strategy. Both allocation and selection were positive.
- The option market and our volatility model are key sources to construct volatility surface. Chinese market's option-based derivatives have been developed rapidly in recent years, providing us more local listed options as well as OTC single stock options. Our in-house AI model has been developed to provide us with the calculation future volatility of options and equities, and it has been improving all the time with more option contract issued.
- The introduction of options on the CSI 300 has also been beneficiary for the strategy as it provides more evidence to derive single stocks volatility patterns.

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## Portfolio Activity

- During the fourth quarter of 2020, we maintained the same number of stocks in the portfolio. The equity allocation did not change drastically during the quarter and was kept above 90%. The position was little changed because the volatility was low, but also because we wanted to keep a low turnover rate.

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## Outlook

- The China's FDI inflow scores 8-month growth streak. Foreign direct investment into the Chinese mainland, in actual use, expanded year on year to 98.7 billion yuan (14.38 billion U.S. dollars) in November, according to the Ministry of Commerce. It marked the eighth consecutive month that the country has witnessed FDI growth. In the first 11 months, FDI rose 6.3% year on year, data shows. Foreign investment in the service industry came in at 704.46 billion yuan during the January-November period, up 16% year on year and accounting for 78% of the country's total FDI. The high-tech services sector saw its FDI climb 32% year on year in the first 11 months, with investment in design services, and research and development surging 93.6 percent.
- Appetite for RMB denominated assets should continue to grow as China will further optimize cross-border Renminbi (RMB) policies and stabilize foreign trade and investment. According to a circular posted on the website of the People's Bank of China, China will promote the facilitation of RMB settlement, simplify the cross-border RMB settlement process, optimize the management of cross-border RMB investment and financing, and facilitate overseas institutions' use of RMB settlement accounts.
- For their part, markets continue to look broadly beyond the immediate term challenges of combating COVID-19, whilst additionally remaining buoyed by unprecedented liquidity from the world's central banks and governments. The much talked about degree of pent-up demand also remains a key support to economies once reopening ensues. In the US for instance, it is estimated that the consumer has an additional \$1.4tr in excess savings since the crisis began. The key question to perhaps answer is by how much has this already been priced into markets?
- The added benefit for equities today is the advantage of lower fixed cost bases which has certainly supported margins. Through furlough and other government support schemes, companies have been able to swiftly and aggressively cut fixed headline costs, far quicker than they have been able to during past recessions. The operating leverage that now resides in companies leaves them well positioned for an economic recovery which often correlates with increasing corporate revenue. The convexity to a normalising growth backdrop is perhaps the greatest in cyclical equities today.

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