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Quarterly Comment | Q3 2019

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

Market Comment

- After a short-term correction at the end of year 2018, Chinese equity markets soon welcomed a strong rebound in January and such positive momentum lasted until mid-April. Driven by a series of reforms and influenced by external investors (like MSCI Inc.), market participants tended to favour more of those with better fundamentals and dividend policies. A most important event was that on March 1 2019, MSCI made an announcement to increase the inclusion factor of A-shares from 5% to 20% in three steps before November 2019. Total incremental fund inflows were expected to be around US$80bn (active + passive funds, with passive funds accounting for 10-20%). That was the reason why blue chips once regained market attention. Small and mid-caps, on the other hand, also delivered strong momentum but the trading appetite tended to be much short-term. Such positive trend closed the first quarter with attractive return, while CSI 300 index, representing large-caps, rose 28.62%, and SME Comp index increased 35.66%.

- However, ever since mid of April, in the shadow of China-US conflicts and a series of threatening from United States, Chinese A-shares started to experience a rollercoaster-type of correction all the way to September. Within, May 2019 was the worst month when most indices unexpectedly decreased more than 7%. Chinese government soon issued tax cut policies and moderated monetary policies with an intention to stabilize the market but the effect seemed to be limited.

- From macro-economic prospective, released data in general were better than expected. China's economic growth remained steady in the first half of 2019 despite headwinds. GDP growth came in at 6.3 percent year-on-year in the first half of this year, meeting the government target of between 6 and 6.5 percent set for 2019. Other indicators, such CPI and PMI also met expectation. The Caixin/Markit manufacturing purchasing managers index, a major privately surveyed index monitoring China's manufacturing sector, even reached 50.4 in August from 49.9 for July, marking the quickest expansion of the sector since March. The CPI in urban and rural areas registered a year-on-year growth of 2.8 percent and 3.1 percent, respectively.

Performance Review

- In the third quarter, the strategy was down -0.90% underperforming the benchmark and creating a negative excess return of -1.85% in CNY.
- Our quantitative model had suggested reducing equity exposure in the first quarter, and such momentum continued in the second quarter. The relative lower equity offered great protection to our portfolio so as to outperform major indices. The result has better reflected the artificial intelligence model for judging the effectiveness in volatile market. Year-to-date, unlike year 2017, investment appetite has been varied and unpredictable, both blue chips of high quality and small caps had experienced selling pressure in rotation.

Portfolio Activity

- As for sector allocation, the top ten sectors accounted for circa 75% of the overall portfolio. This quarter and more recently in September, we mainly decreased positions in banks and increased allocation on food and beverage. TMT related sectors performed the strongest, including electronics, telecommunication, and computer and machinery equipment. Bank and non-financial sectors performed stably.

Outlook

- Starting from the third quarter of 2019, we expect the steady growth and the effectiveness of tax and fee reduction policies introduced in the first quarter to gradually manifest. It is meant to enhance the gradual stabilization and recovery of the macro economy from the remaining of 2019. Accordingly, the performance of A-share listed companies might gradually stabilize and recover in the fourth quarters. At mean time, as regulators intensify efforts to promote the opening of the capital market to external investors and improve the basic system of the capital market in 2019, it is expected to fundamentally shape the A-share market a new and favorable institutional environment for overseas investors.
- Since the second quarter of 2018, trade friction between China and the United States has been the most negative external factor affecting the A-share market. As trade friction continues to evolve in depth, both sides will have a clearer understanding of each other's strength. With the negative impact on the economy gradually emerging, it can be expected that after several rounds of negotiation, China and the United States will certainly adopt a more pragmatic attitude to settle the issues. At the same time, through the observation of the market reaction after several negative information bursts in the third quarter, it is not difficult to find that investors in the A-share market have improved their pessimistic attitude towards the above events and increased risk appetite. Therefore, it can be concluded that the Sino-US trade friction event has significantly reduced its ability to exert negative impact on the A-share market in the future, and the repression on the A-share market will also be significantly reduced.
- This year is the 70-year anniversary of the “New China”. After 70-year struggles and developments, China has indeed well transformed and becomes the second-largest economy in the world. And now, the government continues to focus on how to make the country stronger, especially how to navigate current economic headwinds. Thus, we expect more positive news to be released during National Day season, as strong support to future developments.
- In general, large-cap volatility remain at lower level. Though we expect further downward room to be limited, we remain cautious toward any potential unsuspected events that might drive up the volatilities in order to well balance the risk and return ratio. We will also gradually allocate to small and mid-caps if their volatility continue to decrease

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