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Quarterly Comment | Q2 2019

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Market Comment

- China's PMI contracts in May. China's official purchasing managers index (PMI) for the manufacturing sector slid into economic contraction territory in May. The manufacturing PMI declined for the second consecutive month in May and stood at 49.4, versus 50.1 in April, said the National Bureau of Statistics. A reading above 50 indicates expansion, while a reading below reflects contraction. China's non-manufacturing PMI stayed unchanged from the previous month and stood at 54.3 in May, registering the fifth month in a row with a reading above 54.

- A possible ease on trade tension? Leaders of Group of 20 (G20) economies gathered in Osaka, Japan for their annual event. As the world pins high hope on the high-stakes summit, to steer the global economy out of the current uncertainties and restore confidence in the multilateral system. According to the host Japan, priority topics discussed at the summit include the global economy, trade and investment as well as innovation, among others. However, many expected the talks to heavily focus on ways to ease the current global trade tensions and pave the way for sustainable growth..

- Increasing overseas inflows on the back of June 24th inclusion to FTSE Russell Global Stock Index Series. A total of 1,005 A-shares were added for the first time. FTSE Russell selected 126 stocks to be included during the first stage of inclusion; accounting for 12.54% of the total number. This further highlights the importance of Chinese stocks for foreign investors. The A-share inclusion plan implemented by FTSE Russell will bring in an estimated USD 10bn in net passive foreign inflows, including some USD 2bn I June, according to market consensus. Under the central government's strategy to deepen supply-side structural reforms, the China Securities Regulatory Commission (CSRC) will promote those reforms and the opening-up to facilitate overseas investment entering China's capital market, said the vice-chairman of the CSRC.

- China mulls easing QFII quota management. China's forex regulator said that the country will properly ease and even cancel quota management for Qualified Foreign Institutional Investors (QFII) in a bid to further widen investment scope for overseas investors. There is relatively large room for the growth of overseas investors in China's capital markets as their proportion is still low, said Pan Gongsheng, deputy governor of the People's Bank of China.

Performance Review

- In the second quarter, the strategy was up 1.62% outperforming the benchmark and creating a positive excess return of 3.14%.
- 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

- Overall volatility turned lower to the level of 20% from previous level of 27%, showing overall momentum was much more optimistic. We accordingly increased equity exposure and were able to capture the upward trend later in the quarter.
- In general, total equity holding had increased to around 90%, from a previous 70% level; style-wise, we had increased exposure in consumption sector, the one with better low-volatility feature.

Outlook

- As Donald Trump and Xi Jinping were set to meet at the G20, the market held a glimmer of hope of some positive news. Trump is to deescalate the tariff war because US economy is heading to a slowdown, and the next US$300bn worth of goods will pose a totally different impact on voters' personal spending. China is likely to set its policy on Sino-US economic relationship on its CPC Politburo meeting in July on the basis of G20 leaders' talk. A ceasefire would bring a period of relative optimism on US-China trade war and markets will remain held up by uncertainty for a few more months. However, we reckon Trump will not hold off on flexing muscles using other policies targeting China. Current tariffs are likely to be maintained at least throughout 2020.
- After a slight retreat in early June, the market gradually steadied itself, and then rose slowly until the end of June. The key point was the G20 summit and the Sino-US presidential negotiations in the context of the trade war. The market had reflected a strong anticipation that negotiation this time might probability be successful for both parties. Such positive atmosphere also priced in in onshore derivative. Another positive signal was the shrinking volatility during market downturn and that had offered a great opportunity for us to buy low and increase equity exposure. In general, total equity holding had increased to around 90%, from a previous 70% level; style-wise, we had increased exposure in consumption sector, the one with better low-vol feature.
- Further, we believe the Chinese markets will continue to fluctuate within a wider range. While Sino-US trade war close to be settled, along with a moderate monetary environment, Chinese A-share market is likely to welcome a bull momentum in the near future, just like the trend in the United States during the past 5 years.

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