Fund Manager Perspective

March 2017

Stock Market

Market trend turning positive. Investor confidence recovered significantly as economic indicators continued to improve and the RMB: USD exchange rate steadied. Trading in the market became more active. Although the Index barely moved, there were more structural opportunities.

Earnings driven market conditions continued. Growth stocks which reported good earnings continued to perform well in March, and the structural performance of these stocks is expected to continue. Share prices have moved in tandem with earnings performance, and have also begun to positively reflect Q1 and future longer term growth. Stocks such as these comprise the majority of our portfolio, and the continuation of this trend is positive for our investment style of preferring growth stocks.

Bond Market

As bearish factors decrease gradually and allocation pressure increases, the bond market could see investors taking long positions at the beginning of April. However, given that the market had previously seen some "jumping the gun", we expect relatively limited room for yields to decline this time round. The three major factors that previously restricted yields from declining are: (1) Rising inflation expectations. This was mainly owing to PPI growth having surged during January-February, but the market has, in general, already discounted this bearish factor. On the one hand, the PPI's year-on-year inflexion point would probably come in March while the CPI is expected to remain at February's level of around 1%, all of which will help lower the market's inflation expectations. (2) A rebound in the economic cycle. The inventory cycle coupled with the Juglar cycle will have a relatively strong pull effect on manufacturing investment, and improvement in overseas demand will boost exports. Meanwhile, strong real estate sales in Tiers 3 and 4 cities will underpin real estate investment. At this time, these bearish factors cannot be refuted. However, as PPI gradually falls, and the inventory cycle is expected to move into its latter phase with enterprises switching from actively restocking to passively restocking, as well as more stringent controls over real estate also increasing uncertainty over economic growth, their lag effect is expected to materialize gradually. (3) The introduction of a series of financial regulatory measures including Macro Prudential Assessment (MPA), which was implemented in Q1. In the short term, interbank liquidity conditions are expected to show periodic improvement. Although supervisory regulations on interbank deposits and asset management have yet to be introduced, the market currently expects policy to tend toward "moderate" de-leveraging. As such, reaction toward regulatory bearishness has also begun to lessen gradually. Elsewhere, portfolio duration of institutions at this time are generally shorter. April will see the beginning of a gradual peak in interbank deposit maturity. Banks' willingness to continue to issue such paper has been affected by regulatory policy resulting in uncertainty. These together have increased the pressure on reinvestment when interbank deposits mature. Taking all of the above into consideration, given less bearish factors and larger institutional allocation pressure, investors taking long positions in the market are expected to increase further. However, with some in the market having "jumped the gun" by having taken long positions at mid- to late March, this means that the bullish factors mentioned above have already been partially priced in, leaving less room for yields to continue to decline.

Overseas, global bond markets saw yields generally falling during the holiday period. In particular, 10-year US debt declined by almost 10bp to close at 2.33%, near its previous low of 2.31%; 10-year German debt similarly declined by almost 10bp to close at 0.255%, while 10-year French debt declined by approximately 5bp to close at 0.92%. Two factors have led to stronger global bond markets as a whole: First, the "Trump deal" has begun to ebb rapidly. On the one hand, the failure to push through the health care reform plan has caused the market to further lose confidence in Trump. On the other hand, with the Republican Party's Supreme Court nominee likely to face obstruction as regards his nomination, this has exacerbated the market's lack of confidence in the Trump cabinet. (2) French election uncertainty and the explosion between two metro stations in Russia have raised global risk averse sentiment, which have benefited gold and other risk averse assets including the bonds of developed nations. As far as the domestic market is concerned, given that for a period of time in the past, China and US bonds have been relatively highly correlated, a significant decline in US bond yields will, to a certain extent, benefit the performance of treasury bonds.

A recent key feature of the bond market is the flattening of the yield curve. The current flattening of the yield curve could last for a fairly long period of time. The core rationale lies in believing that when policy rates are rising gradually, the room for a decline in the short end would be relatively limited, thereby restricting the performance of long-end rates. Based on the current market environment, on the back of easier funds availability, short-end rates are expected to decline somewhat at the beginning of April. Long-end rates are also expected to decline accordingly because of investor preference for long positions. Spreads of similar maturities will remain relatively stable. These will result in a flattening and declining of the yield curve.