Fund Manager Perspective

September 2017

Stock Market

The market views are converging, and the indexes fluctuate within narrow ranges. The economic growth recovers further, and the monetary policy continues to be relatively tight, with the fluctuation range of the RMB exchange rate initially formed. As the investors are gradually reaching the consensus for the macro trend, the market has seen the volatility drop significantly and maintained the steady uptrend.

The view of the market style turning to the growth is gradually spreading in the market. The growth stocks are more and more active, and among them the stocks with small and medium-sized market value that are certain in growth of performance and undervalued are increasingly sought after.

With regard to the stocks of small spacing display. For example, the small spacing display industry is expected to maintain a 50% growth in the next two years, represented by Leyard and Unilumin, who have always kept a growth rate of more than 50% and are expected to extend the trend in the next two years. However, the project-oriented business mode with the cash flow far less than the net profit has caused the market to question the quality of their growths, and in the past year the two stocks registered small increases. At present, the PE17 figures of the two companies are less than 30 times with the PE18 below 20 times. Since September, Leyard has shown a strong uptrend, which we expect to continue.

Bond Market

Money Supply Expected to Improve, Fundamentals are Relatively Adverse

In late September, the money supply was tighter than expected, mainly represented by remarkably high prices of exchange funds and the significantly widening interest rate spreads of the inter-bank funds. The overnight funds, for example, saw the weighted average price of 204001 stand at 12.97% on September 29, with the interest rate spread against the inter-bank overnight funds expanded to 10.2 percentage points, a new high in the year. The phenomenon was mainly caused by two factors. On the one hand, great changes to the supply and demand of the exchange funds took place in the short run, and on the other hand, there was no effective arbitrage mechanism between the exchanges and the inter-bank system.

First of all, in terms of the demand for the exchange funds, the balance to be repurchased estimated on the basis of the trading volume was significantly increased at the end of September, which means that the demand for the exchange funds went up markedly in the period of time. But the increased demand for funds did not stem from the lifted overall leverage ratio in the market, but the transfer of the inter-bank financing demand to the exchanges. With regard to the inter-bank collateralized repo, the trading volume shrank substantially in late September. In addition to the factor of preparing for the next quarter in advance, another important reason was that the banks reduced the funds financed to the non-banking institutions because of the MPA and LCR assessment at the end of the quarter. As the funds financed to the non-banking institutions in contrast to the deposit institutions are included in the generalized credit, the pressure of the MPA assessment will make it much more difficult for the non-banking institutions to borrow money form the banks, and the LCR requires the banks to reduce the overall net outflow of funds. The above-mentioned two assessment processes forced some demands for inter-bank financing to transfer to the exchange market, thus increasing the demand for the exchange funds; Secondly, from the perspective of the supply of the exchange funds, the financing intention of the retail investors and the stock-based products, the most important suppliers of the exchange funds, is significantly affected by the performance in the equity market, and the financing intention has been dampened by the heated expectation for a bullish equity market with the stock market stabilizing at a high level recently and the number of the newly opened accounts picking up continuously. To sum up, the financing demands squeezed out by the inter-bank channel, the financing intention suppressed by the stock market, coupled with impact of the end of the quarter, have resulted in the further imbalanced supply and demand of exchange funds as well as the soaring prices.

In addition, currently the lack of the arbitrage mechanism between the inter-bank system and the exchanges also makes it difficult for the widened interest rate spreads to restore rapidly. On the one hand, the participants in the two markets are starkly different and there are limited types of institutions that can conduct cross-market arbitrage. On the other hand, the T+0 settlement adopted by the inter-bank system compared with the T+1 settlement applied at the exchanges means that there are great uncertainties in time for the funds financed in the inter-bank system to conduct arbitrage at the exchanges. With the quarter-end assessment finalized in October, the intention of the banks to finance the non-banking institutions is expected to improve, making the financing pressure on the exchanges likely to be eased; but because of the encouraging economic data released recently, the upcoming 19th CPC National Congress and the buoyant overseas markets, it is unlikely to see the optimistic expectation for the stock market to ebb, and the financing intention of the exchanges is expected to be still weak; therefore, the prices of the exchange funds are expected to decline in October on the whole, with the drops unlikely to be significant. In the inter-bank market, the impact of the taxes paid for the third quarter in mid October on the money supply is worth noticing, but the central bank is expected to hedge by stepping up the operation in the open market for political reasons. Therefore, the possibility of significantly tightening the money supply is low.

In the real economy, according to the PMI and the high-frequency data, the September industrial data is very likely to show phased rebounds, the PPI may once again ascend, and the fundamentals are comparatively detrimental to the bond market. But in the fourth quarter, the economy is still likely to go down slowly for the following reasons. First of all, in the heating season the rates of operation will decline at the enterprises in northern parts of China, putting the industrial output growth under the downward pressure; secondly, the real estate sales have begun to fall, the regulatory and control measures for the third and fourth-tiered cities are expected to be introduced, the dropping sales will be transferred to investment, and the real estate investment growth is expected to slide down; thirdly, under the pressure of financial revenue and expenditure, the growth of investment of capital construction will tend to slow down. In the overseas markets, initial progress has been made in Trump's tax reform policy, coupled with the employment rate and salary growth higher than expected in September, making it more likely to raise the interest rate in December, and the US bond yields are in the face of upward pressure, with the interest rate spreads between China and the US expected to be narrowed further.

In terms of the bond market strategy, considering that the economic data may be better than expected, therefore in the situation of targeted cut of deposit reserve ratio which is good news for cashing, the trading positions can be closed for profit taking, so as to wait for the opportunity of participation after the yields picking up again; with regard to the allocation-oriented demand, considering that the money supply is very likely to see a smooth transition in October, the arbitrage space is expected to transform from negative to positive. Meanwhile, at present the coupon rate protection is still relatively sufficient, and without the foundation for the yields to go up sharply, it is still advised to maintain a moderate portfolio duration.