

10 August 2020

China Market Strategy

China-US Rivalry: What It Means for Stocks

On 30 April 1984, President Reagan's visit to China culminated in a speech to the students and faculty at the Fudan University in Shanghai. It is the first American presidential visit to China, 12 years after Nixon's. Back then, the US needed an ally in the Cold War, and China was just opening up to embrace the world.

It was a beautiful speech. Among the many lines of heartfelt eloquence spoken during the speech, these words are particularly memorable – “... *No people on Earth are more worthy to be trusted than those who have worked hard for what they have. None is less inclined to take what is not theirs* ...” These words from a different era contrast sharply to the confrontation today. As the tension between the two powerful nations escalates, the market remains jittery. The news on a ban on Tencent in the US pushed the stock plunging 10% at its worst. And US-listed Chinese companies were hit hard during the Friday night US trading.

Obviously, stocks are fraught with headline risks heading towards the November election. Since 2017, Trump's Job-disapproval Poll has shown a tight correlation with the Shanghai Composite and the index of US-listed Chinese companies. Trump's poll has led by 30 to 50 trading days (**Figure 1**). Recently, Trump's job disapproval poll has indeed improved, either because the peak of the second COVID-19 outbreak in the US may have passed, or because of his hawkish stance towards China. Given the historical correlation, Chinese stocks will continue to face strong resistance from a trading perspective amid headline risks.

Meanwhile, the Chinese economic data continue to show improvement. PMI continues to expand, with improvements in the new export order index and raw materials purchase. The trade balance was a blowout, driven mostly by exports of medical supplies. And foreign reserve rose slightly. Our high-frequency data are showing continued improvements in city road and subway traffic, property sales and production output.

However, despite the continuing V-shaped recovery, consumer confidence remains very subdued. Indeed, consumer sentiment has plunged to all-time low and diverged from the performance of stocks and bonds (**Figure 2**). Consumer sentiment has been a contrarian indicator in the past, and at such depth it used to portend market bottoms. But depressed consumer sentiment is also a reflection of the consumption part of the real economy, which is still struggling and will still need help. We would not be too carried away by strong medical supply exports and the consequently better trade balance, nor by the improving PMI and high-frequency data. These observations show the strength in the manufacturing industry may not last if overseas demand falters. The mantra of an “inner circulation” economy emphasizes spurring domestic demand.

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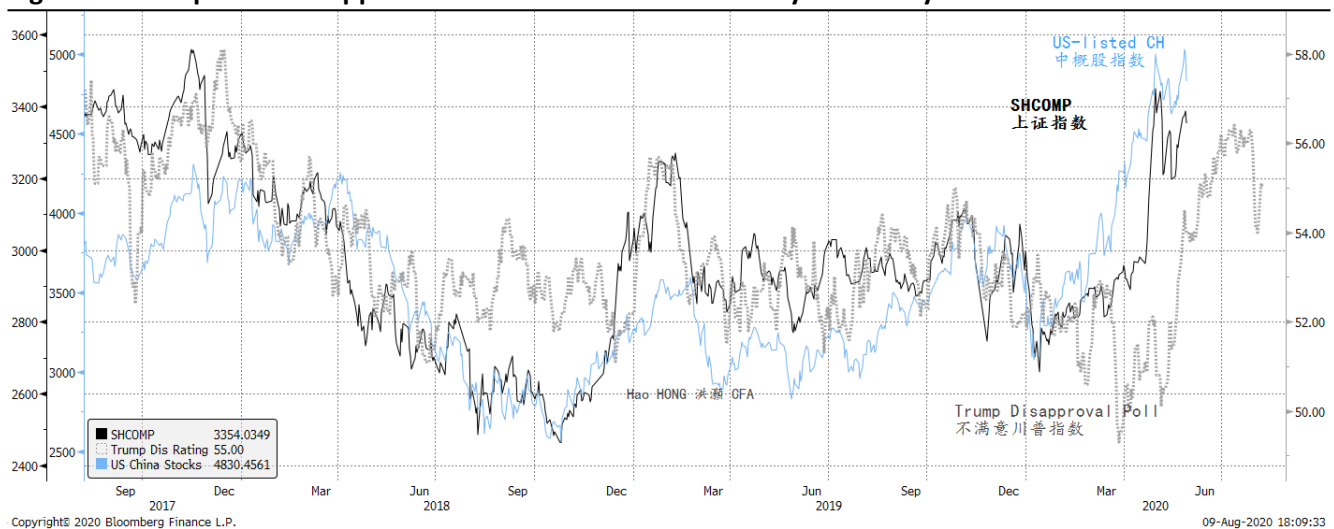
Head of Research

The market continues to concern itself about a monetary “fine-tuning”, because of recent strong property sales. We would argue that monetary policy is always being fine-tuned, especially at a time when the external environment is fraught with risks. While property sales were strong in July, sales had remained below last year’s levels YTD, while property price rose at a measured pace, except for some individual cities. As such, price and sales growth suggest supply and demand are largely in balance, and there is no sign of nation-wide speculation.

Indeed, the PBoC has been the most disciplined central bank amid the COVID-19 outbreak. Consequently, the yield spread between China and the US has expanded to an elevated level that used to suggest resistance for stocks and resilience in the RMB (**Figure 3**). As the rivalry between China and the US escalates, monetary policy, now with preserved leeway from previous self-restraint, can be used as a counter-cyclical instrument should the impact on the economy intensify.

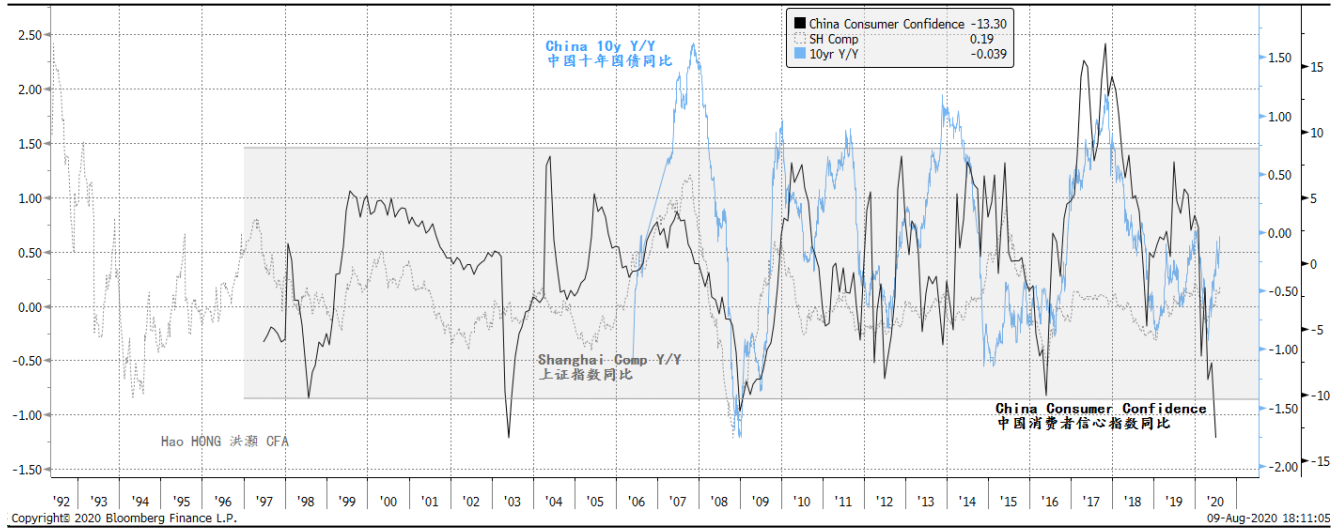
In sum, Trump’s hawkish stance towards China will be a headwind for Chinese stocks, and the depressed Chinese consumer sentiment suggests an uneven economic recovery. But the heightened yield spread suggests that China’s policy is tight relative to the US, and therefore leaves leeway for policy maneuver to cushion some downside risks for stocks. Given the market and economic data we presented above, policy should remain supportive. And the clear communications from the central bank, as well as our charts presented here, suggest limited room to game the future policy direction for speculators for now. Again, 3,500 remains a significant hurdle for the Shanghai Composite.

Figure 1: Trump’s Job Disapproval Poll leads Chinese stocks by 30-50 days



Source: Bloomberg, BOCOM Int'l

Figure 2: Chinese consumer confidence plunges to all-time low, despite a market recovery



Source: Bloomberg, BOCOM Int'l

Figure 3: China's monetary policy must consider spillovers from foreign central banks



Source: Bloomberg, BOCOM Int'l

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Broad market benchmark for Hong Kong is the **Hang Seng Composite Index**, for China A-shares is the **MSCI China A Index**, for US-listed Chinese companies is **S&P US Listed China 50 (USD) Index**.

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