China Economy

July asset allocations: short-term congestion in growth stocks reminiscent of consumer stock trend in early 2021

In equities, the current short-term congestion in growth stocks reminds us of the congestion in consumer stocks in early 2021. In bonds, we see loosening medium and long-term liquidity expectations, while in commodities, the high oil price cycle has likely ended. With high USD volatility, stocks, bonds and exchange rates are appearing slightly risk-off.

Week 3: Asset performance

The main US stock indices fell in the third week of July 2021. The Wind A share index increased 0.84% on a turnover of RMB6.1tr while volume surged. In the lead among Class I industries were coal, steel and petroleum and petrochemicals, while electronics, agriculture and automobiles lagged behind. The Credit Bond Index rose 0.31% and the Government Bond Index rose 0.43%.

Week 4: Value and growth opportunities in major categories

Equities: the current short-term congestion in growth stocks is similar to the congestion in consumer stocks in early 2021.

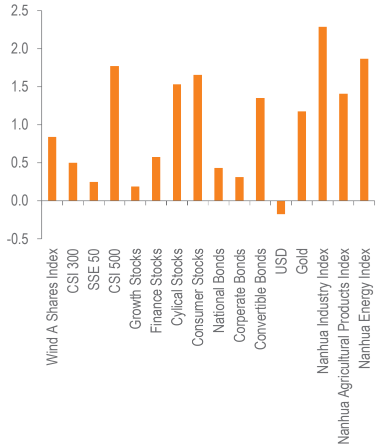
Bonds: loosening medium and long-term liquidity expectations.

Commodities: the periodic highs in oil prices could have passed.
FX: high USD volatility continues.

Global: Market concerns have abated with the sustainability of the economic recovery; stock, bond and exchange rates are showing a slight risk-off structure.

Risks include: pandemic outbreak resurgence; industry boom falling below expectations; and monetary policy tightening more than expected.

Sector performance chart



Source: Wind, Tianfeng Securities

Risk premiums across assets and investment strategies in July Week 4

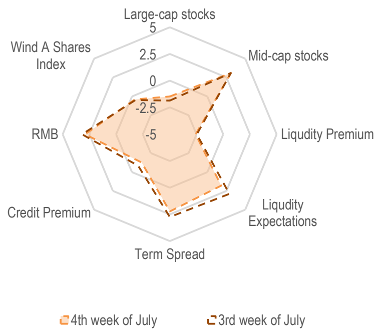


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Chart 1: Yield rates across asset types in July Week 3 (%)

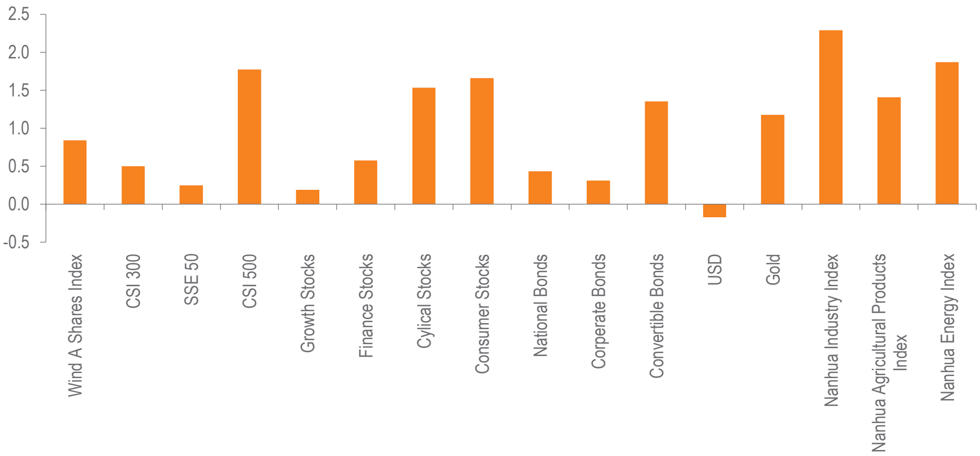

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Chart 2: Risk premiums across assets and investment strategies in July Week 4

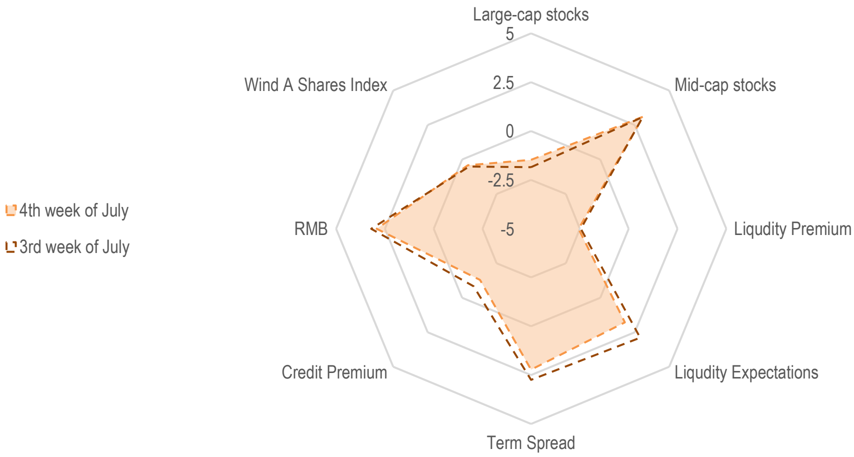

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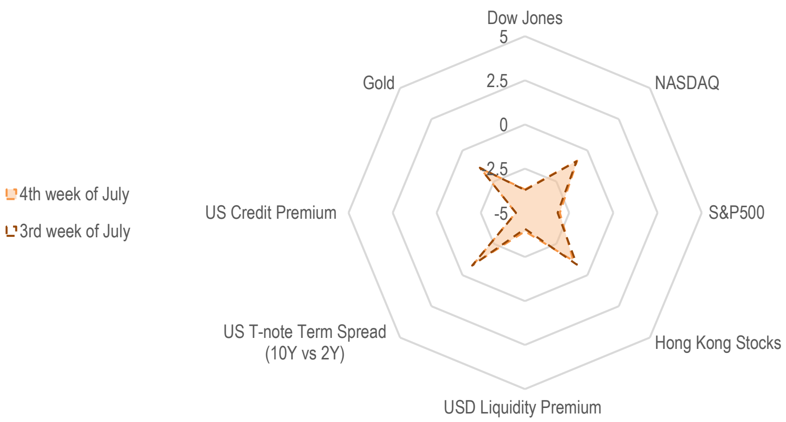
Chart 3: Risk premiums across global assets and investment strategies in July Week 4



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Note:

Equity risk premium represents the risk-return ratio of a stock; the higher the risk premium, the higher the risk-return ratio.

Liquidity premium is market price being mapped to current liquidity tightness; liquidity expectations are the market's expectations of long-term liquidity tightness.

Equities: short-term congestion in growth stocks recalls consumer trend in early 2021

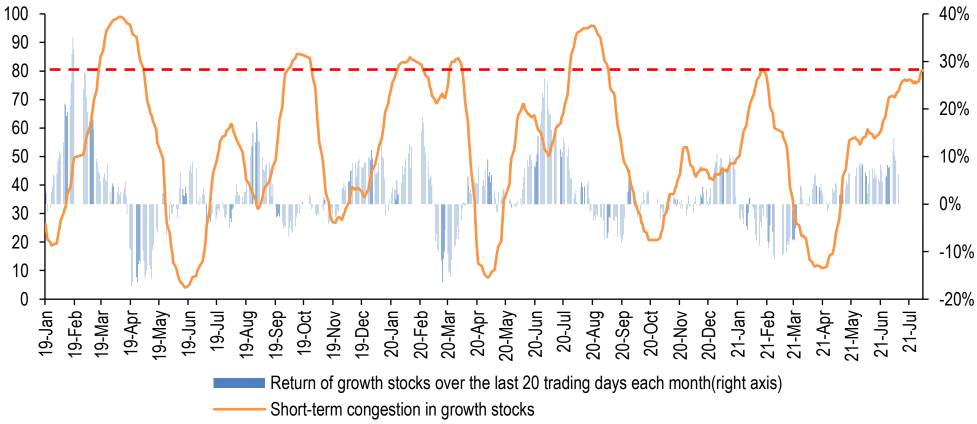
Economic data in June revealed that, except for weakness in real estate and infrastructure construction being in line with expectations, other factors like industrial growth, manufacturing investments, retail sales and exports performed better than expected. In 2H21E, affected by headwinds in real estate and exports, we expect the economy will decline moderately. Therefore, 2Q would represent the year's peak economic growth (with two-year compounded and seasonal adjustments). At present, profitability at most industries is at relatively high levels. As the economic growth rate declines, however, industry profitability trends would start to differentiate. As 2Q earnings results reporting proceed, we expect granular changes to be the focus of market attention.

Growth, finance, cyclical and consumer stocks rose 0.19%, 0.58%, 1.53% and 1.66% respectively in the week. After the RRR cut, liquidity premium remained at a relatively low position around the 24th percentile, and liquidity is expected to decline rapidly from the previous period. Large-cap stocks (SSE 50 and CSI 300) rose 0.25% and 0.50%, and mid-cap stocks (CSI 500) rose 1.77% (Chart 1). The risk premium of Wind A shares was basically the same as in the previous period, and is currently at the level of neutral and is slightly more expensive (Chart 2). SSE 50 is still more expensive, the valuation of CSI 300 is neutral to expensive, and the valuation of CSI 500 has fallen further, entering the cheap range. Valuations of financial stocks are cheaper, growth stocks are cheaper, and the cycle is neutral to cheaper, while consumer stocks are neutral to slightly more expensive.

In the third week of July, net southbound fund inflow amounted to HKD8.65bn. Risk premium of the Hang Seng Index (HSI) stayed basically the same as in the previous period (40th percentile) and the HSI maintained a neutral to low profit-and-loss ratio. Market sentiment was highly varied in terms of market value. The derivatives market was relatively optimistic about mid-cap stocks and cautious about large-cap stocks. The futures spread of CSI 500 dropped to the 65th percentile and the spread of SSE 50 and CSI 300 was between the 17th and 22nd percentiles. Short-term trading congestion in SSE 50 and CSI 300 remained in the lower positions of 20th and 32nd percentiles, while the congestion of mid-cap stocks rose above the median.

Segmentally, the growth of short-term transaction congestion reached the 80th percentile, close to the level of consumer congestion at the end of January this year (85th percentile), and the turnover rate of the STAR Market was close to the historical high of 5%. Since 2019, the growth sector has been in the 80th percentile eight times, and fell an average of 1.95% in the next 20 trading days (Chart 4), rising 4 times (averaging 4.72% in the next 20 trading days) and falling 4 times (average decline in the next 20 trading days was 8.62%). The current short-term congestion in consumer and financial transactions is low, and the cyclical congestion is at a medium to high level.

Chart 4: Short-term transaction congestion in growth stocks (2019-present)



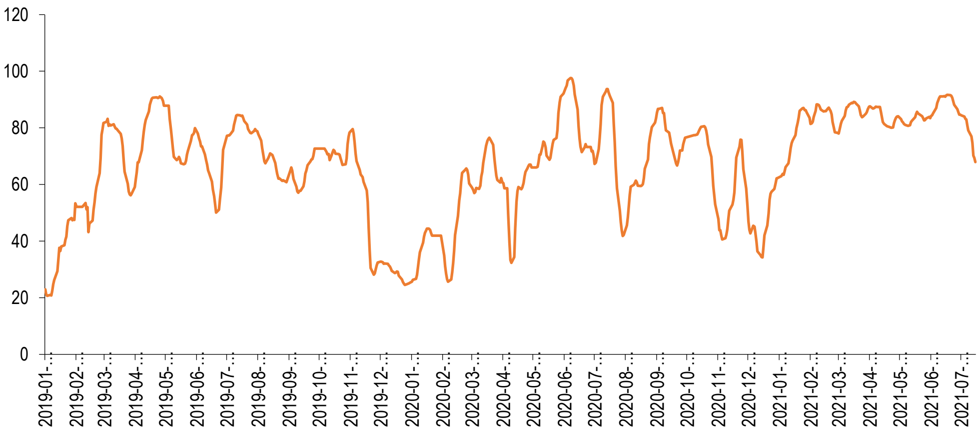
Source: Wind, Tianfeng Securities

Bonds: low liquidity premium and easing shift medium and long-term liquidity expectations

In the third week of July, the liquidity premium hovered around the 25th percentile. After the National Standing Committee announced on 7 July that it would employ RRR cuts in a timely manner, liquidity premium returned to a relatively relaxed level. On 15 July, the central bank lowered RRR by 50bp, releasing about RMB1tr, and renewing RMB100bn of MLF equivalents. After the RRR cut, it seemed highly likely that liquidity easing would continue in the short term. Mid to long-term liquidity expectations have dropped rapidly into the 68th percentile, and concerns about future liquidity tightening have dissipated. Term spreads have also begun to fall (72nd percentile) and the term structure could flatten further. Long-term bonds are still more cost-effective than short-term ones. The credit premium fell slightly (37th percentile), with overall credit bonds in a less cost-effective position.

In the third week of July, bond market sentiment rose, short-term congestion in interest rate bonds went back above neutral (58th percentile) and short-term congestion in credit bonds neared the median (48th percentile), while congestion in convertible bonds rose above the median (59th percentile).

Chart 5: Liquidity expectations



Source: Wind, Tianfeng Securities

Commodities: OPEC+ stabilizes; crude oil supply could improve a bit

In the third week of July, operational rates in major industrial sectors were mostly flat or rebounded. Prices of industrial products mostly rose: rebars and hot-rolled coils continued to rise while coal prices rebounded from being previously oversold.

The China Iron and Steel Association stated on 17 July that it had completed the first draft of its implementation plans toward a carbon peak for the iron and steel industries. To ensure yoy reduction targets in crude steel output are met in 2021, many provinces and cities report their steel production reduction goals and tasks. The national steel market is widely expected to reduce production in 2H21. However, real estate construction and infrastructure investments are unlikely to exceed expectations in 2H. Thus, a decline in demand would pose strong resistance to the steel price trend.

In the third week of July, the LME gold price traded within a narrow range around USD1,811.61 as copper fundamentals gradually reached a balance. Processing fees continued to rise and copper prices are currently in a shock range. COMEX Copper's non-commercial congestion remained in the 55th percentile and market sentiment is neutral.

In the third week of July, the Brent price fell 2.98% to USD73.30/barrel. OPEC+ reached an agreement to increase production, which coincided with the fall of the PMI high in the US ISM service industry, superimposed by peak oil consumption in the summer. The high crude oil price cycle could be completed. US crude oil inventories also rebounded slightly this week. US shale oil supply is slowly recovering due to high oil prices. Marginal changes in shale oil supply are a key factor in oil prices. In the derivatives market, discount rates of main oil distribution contracts relative to 6-month futures contracts remain above 5%. The market continues to expect long-term crude oil supply to hinder crude oil futures prices.

In the third week of July, risk premium of the energy and chemical product index remained in the 10th percentile with expensive valuations. Risk premium of the industrial product index was at a historical low and valuations were expensive. Risk premium of the agricultural product index remained in the 11th percentile on expensive valuations.

FX: Powell: easing to continue; US dollar rangebound

In the third week of July, the US Dollar Index continued to trade within a narrow range of 92-93. The gap in economic growth between the US and Europe continued to converge but at a slowing pace.

In the week, USD/CNY (onshore) continued to trade within a narrow range around USD1:RMB6.50. Short-term trading congestion in the RMB was at a relative low. Northbound weekly net inflow came to RMB1.67bn, while global net weekly inflow of funds to Chinese stocks and bonds turned positive, with financial market capital flows having a neutral effect on the RMB rate. Corresponding to the USD trend this year, RMB has traded in both directions this year and could depreciate slightly in the medium term as the Fed's QE taper approaches.

Overseas: economic recovery begins; stocks, bonds, FX looking a bit risk-off

US economic data in June was mixed. The good news is that the number of initial claims for unemployment benefits fell to 360,000 in the week of 10 July, the lowest level in the nearest 17 months; while retail sales in June increased 0.6%, exceeding market expectations. The bad news is that the growth rate of industrial output fell to 0.4%, lower than the expected 0.7%. The University of Michigan Consumer Sentiment Index fell to 80.8 in July from 85.5 in June. US CPI rose to 5.4% in June, higher than the expected 4.9%, and higher than 5% in May. Core CPI rose to 4.5%.

On 15 July, US Federal Reserve Chair Jerome Powell reiterated at a senate hearing that monetary policy would continue to be strongly supportive. The market is expecting the Fed to be more hawkish this year than the European Central Bank, but it now appears that short-term liquidity in the US and Europe will remain loose. With concurrent twin expectations of easing liquidity and economic stagflation, real interest rate has fallen further to beyond -1.0%. The 10Y breakeven inflation expectation rebounded 5bp from last week and the 10Y US bond yield rate dropped to 1.31%. US bond yield rates and US stocks fell, the USD wobbled sharply and bonds showed a slight risk-off structure as market concerns grew over the sustainability of the economic recovery and risk appetite continued to decline.

In the third week of July, US bond term premium remained in the 42th percentile and USD liquidity premium and credit premium were close to their historical lows in the 10th and 5th percentiles. Risk premiums of S&P 500 and Dow Jones were in the 20th and 13th percentiles of the past 10 years respectively (1.10 and 0.90 standard deviations below the median), and risk premium of Nasdaq was also in the mid to low position (Chart 3) while US stocks continued to have relatively expensive valuations.

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		Neutral	Expected relative return over stock price between -10% and 10%
		Sell	Expected relative return over stock price below -10%
Industry investment ratings	within 6 months from the report issuance date, increase or decrease relative to the Index of the jurisdiction of the Industry in the same period	Outperform	Expected increase of industry index over 5%
		Neutral	Expected increase of industry index between -5% and 5%
		Underperform	Expected increase of industry index below -5%

Jurisdictions	Index Used for Ratings Definitions
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Contact

Hong Kong
TFI Asset Management Limited
11F, Nexxus Building, 41 Connaught Road Central, Hong Kong
Email: research_tfi@tfisec.com
Tel: 852 3899 7399