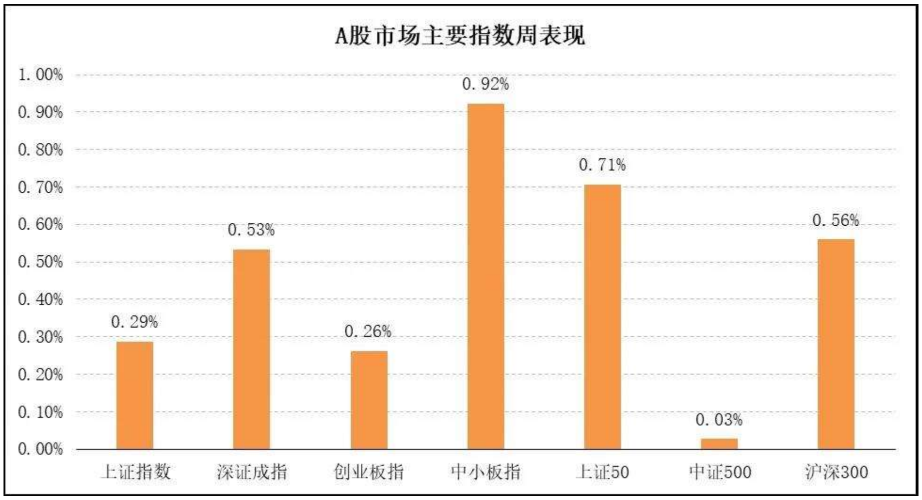
Rosefinch Weekly

Capital shifting temporarily to risk-averse sectors

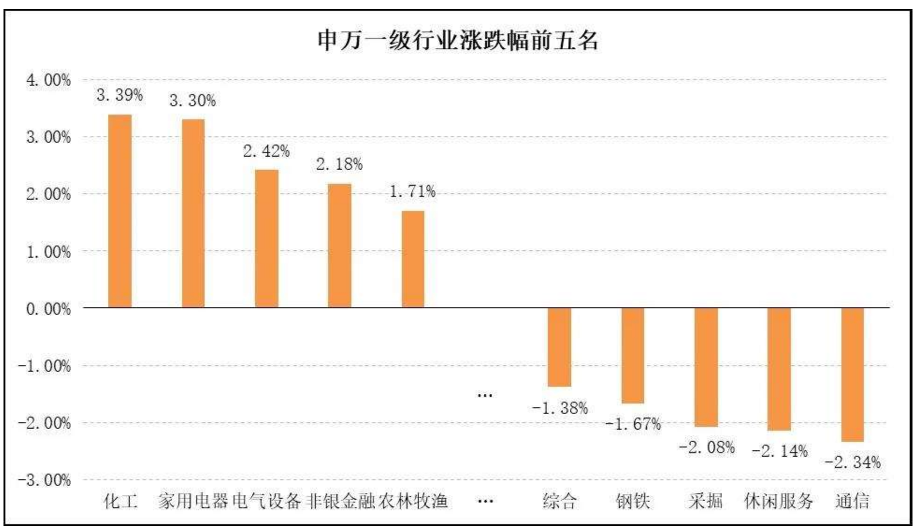
1. Market Review

For the last week: SSE was +0.29%, SZI was +0.53%, GEM was +0.26%, SSE50 was +0.71%, CSI300 was +0.56%, and CSI500 was 0.03%.



Source: Wind, Rosefinch.

Amongst the ShenWan Primary industries, 16 out of 28 rose: chemicals, household appliance, electric equipment, non-bank financial, forestry & fishery led the way.



Source: Wind, Rosefinch

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Market volume recovered, with Northbound net +23.3 billion RMB, and Southbound net +4.1 billion HKD.

Source: Wind, Rosefinch. Blue is cumulative Northbound flow and unit is 100 million RMB; yellow is cumulative Southbound flow and unit is in 100 million HKD.

2. Market Outlook

Last week saw releases of 3Q GDP which had a annualized growth rate of +4.9% since 2019, a noticeable slowdown from the 2Q's +5.5%. The 3Q economic growth was hit with several transitory factors like the severe rainstorms, localized Covid spreads, and some regional electricity rationing. On the real estate front, both land purchases and home sales remain in downward trend. This is putting a drag on fixed investments and infrastructure investments, while manufacturing investments rebounded somewhat. Sep retail sales rose +4.4%, higher than Aug's 2.5% but still much lower than the pre-pandemic levels. Sep industrial production was impacted by electricity shortage and slowed to 18-month low of +3.1%. While we expect some improvements going forward, we'll still likely see electricity constraints on energy-intensive industries, as well as sporadic Covid spreads. Meanwhile, both the real estate and the consumer sectors remain relatively weak in 4Q. Even though some real estate financing policies are loosened, we see the ongoing real estate developer saga to hit consumer confidence, especially in 3rd or 4th tier cities where the developer has large presence. The 1st or 2nd tier cities had lackluster land auctions recently, thus signaling any short-term investment-led rebound is unlikely. For the consumers, the outlook for SME's growth has weakened, thus reducing household income, and weakened consumer confidence in an already uncertain economic environment. Based on all these considerations, we think 4Q economic growth will be under clear pressure. It may be slightly better than 3Q, but likely to remain in low growth levels due to higher base.

On macro policy level, the PBOC run Financial News published editorial on Tuesday to stress 4Q focus is still to maintain reasonable ample liquidity, thus reducing some of market's tightening expectations after the new conference from previous Friday. Currently, PBOC is still maintaining relatively steady liquidity, and keeping neutral tone in its market guidance. The monetary policy is kept at relatively balanced level.

The recent government push to secure power supply and stabilize coal pricing tried to correct over-zealous carbon-reduction moves. This is however focused on coal and domestic heating related supplies, and not a relaxation on the constraints for high-total-energy and high-peak-energy projects. The commodity prices will likely remain volatile at relative high level in the medium term. Last week, the NDRC announced guidelines to curb speculation on coal prices. This is improving the fundamentals in coal market with higher daily productions and increased inventories. Thermal coal contracts saw sharp price falls, thus pushing down industrial goods that's very coal dependent like coal-chemical, coal-related commodity, construction material, non-ferrous metal, steel, etc. The commodity prices tend to reflect short-term supply and demand balances, while the cyclical stocks tend to reflect long-term profit forecasts. Last round of commodity rally was mostly due to proactive supply constraint, and not stronger demand. It's therefore unlikely to be sustained, and indeed we saw correction last week. Whereas cyclical stocks had already peaked before commodities in September, with clear divergence from commodity prices – easy to fall with commodity, but hard to rise when commodity rallies.

A-share recently are getting choppy with lack of consistent main themes. There are style rotations amongst new energy, consumer staple, financial or real estate, which are mostly tactical in nature. Market is now seeing some temporary bias towards more "risk-averse" investments like food & beverage, individual sector leaders, low-valuation companies, and other higher-certainty investments. We still see favorable outlook for photovoltaic and new energy vehicle companies where the relatively high valuation is not a major problem yet. New energy sector has very clear industry logic to alleviate pressure from lack of traditional energy source and to generate new investments. The new energy's upstream material costs can also be effectively passed to downstream, thus making the industry chain a more certain one. Household consumption though hasn't seen a fundamental improvement. The real estate industry chain lacks favorable long-term investment thesis given the "housing is for living, not speculating" environment. Market daily turnover has remained under the 1 trillion RMB mark so the market activity has reduced. Even though the liquidity growth rate is bottoming out, it doesn't mean monetary policy will loosen. Some of the recent corrections in the real estate financing policy implementation is not a shift in policy direction, but a marginal adjustment to improve normal funding needs of real estate and households. By accommodating reasonable first-house financing, it'll reduce liquidity pressure on the real estate developers, and prevent risks from spreading to the wider real estate industry chain and the financial system.

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