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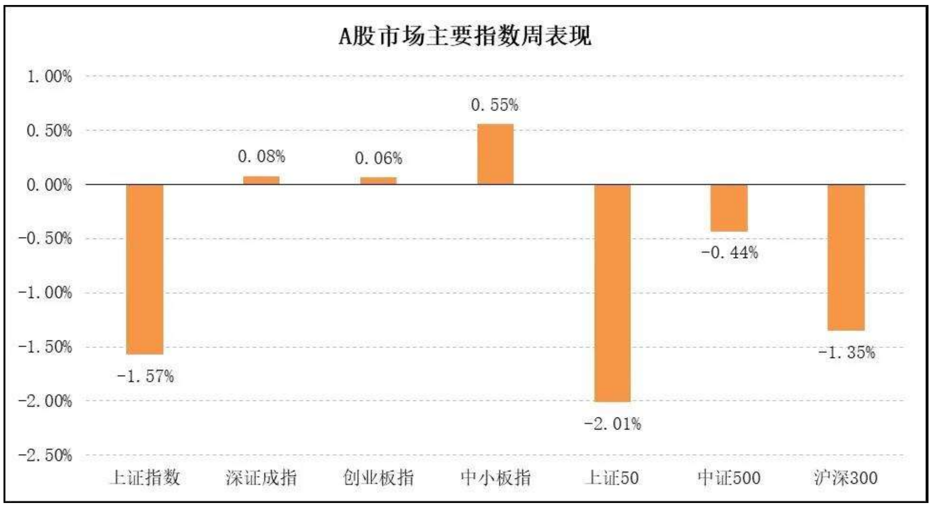
Rosefinch Weekly

Real Estate still searching for bottom, some consumer rally now over-extended

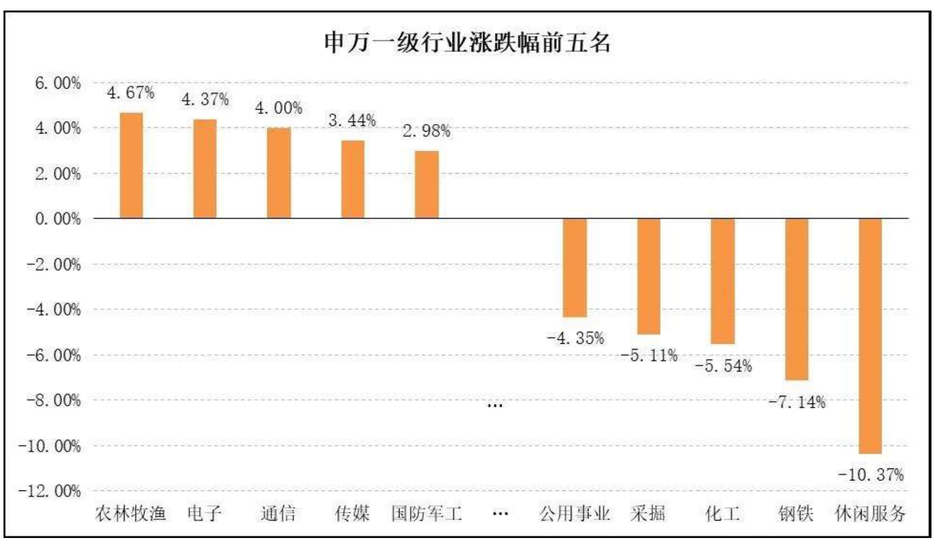
1. Market Review

For the last week: SSE was -1.57%, SZI was +0.08%, GEM was +0.06%, SSE50 was -2.01%, CSI300 was -1.35%, and CSI500 was -0.44%.



Source: Wind, Rosefinch.

Amongst the ShenWan Primary industries, 12 out of 28 rose with agricultural, electronics, communications, media, defense leading the way.



Source: Wind, Rosefinch

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Market volume dipped with Northbound net +4.4 billion RMB, and Southbound net +0.7 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

In last week's Oct manufacturing PMI, it lowered further to 49.2 from 49.6 in September. This leading indicator shows manufacturing sector sentiment outlook has been declining for seven months, signaling more pressure ahead. From economic fundamental perspective, both supply and demand are soft: the supply side is still impacted by the energy constraint policies and the higher commodity pricing in early to mid Oct; on the demand side, there's still pressure on real estate investments, while consumer sentiment is not showing big pickup. Overall, manufacturers are facing relatively large demand drop pressure. Service PMI also saw drop from Sep's 52.4 to Oct's 51.6, with employment index down another 0.3% to 46.6%. Service sector outlook has not returned to pre-pandemic levels, with clear impact on overall employment.

On macro policy front, this week's People's Daily published editorial with more detailed discussions on the cross-cycle framework. First, cross-cycle doesn't mean abandoning counter-cyclical tools. The economic cycle is impacted by short-term cyclical factors and therefore need some adjustments from counter-cyclical tools. Both traditional counter-cyclical tools like monetary and fiscal responses still need to engage at necessary junctures. Second, the economic policy making requires more systematic and strategic considerations, combining various industry policies for adjustments. In recent times, there's been a decrease in frequency of traditional monetary or fiscal policies, but they still showed results especially during post-pandemic periods. In addition, macro policy is also reducing reliance on traditional policy tools, and more actively using new industry or strategic policy to address long-term structural issues.

Looking forward, we're entering period of economic slowdown. The macro policy will see higher likelihood of counter-cyclical adjustments, though with restrained magnitude as to avoid excessive stimulus. Overall, the main engagements will be through structural policies.

With the ease of Chinese inflation expectations, there's less risk of higher yield curve in fixed income market. Some allocation to fixed income will reduce tail-risk of sharp slowdown. On the softer commodity front, the drop was previously led by thermal coal, and now led by those with weak demand. This week A-share was soft and volatile. SSE dropped -1.57% and finished below 3500, while GEM did well. Among industries, agricultural, communication, and electronics led, but cyclicals dropped. 3Q profits were softer than half-year reports. The macro policy pressure will pass through company's profits and show up in the 4Q reports. We had previously highlighted how cyclical stocks peaked before commodities. The coal, steel and other cyclical industries have dropped for 8 weeks now since mid-Sep. When commodity rally evolved from economic pricing to impacting social well-being, it became a policy risk issue, thus giving more upside limit for coal companies' long-term performances. Now both commodity and cyclical stocks have shifted from supply-shortage induced inflation risk to weak-demand induced stagnation risk. With real estate sector still languishing, the industry chain such as steel and construction material will find it hard to rally. Given the clear policy and weakening of credit-led growth framework, real estate is still searching for the bottom.

Some of the funds flowed out of cyclicals and moved to new energy sector with strong outlook and consumer stocks with good bottom picking capabilities. The new energy sector is facing a high valuation situation, which takes time to digest and may experience high volatility. Consumer side, there was a recent wave of rallies among food companies and non-housing related electronics companies. Some have rebounded sharply with rallies of 30-50% which may be excessive and warrants caution.