Technology Assets From Capital Expenditure to Cash Flow Validation

Last week, the market followed a pattern of rallying before pulling back. The key tension underlying the week's trading can be summarized as "domestic policy providing the initial catalyst, while external developments dampening sentiment."

For the week as a whole, major indices still closed higher. However, upward momentum weakened considerably on Friday, accompanied by a notable increase in volatility. At the sector level, the market was dominated by two major themes, AI applications and new energy, with limited rotation between them. Trading volumes fluctuated in line with market sentiment: turnover exceeded RMB 2 trillion on Wednesday and Thursday before contracting again on Friday.

Policy Tailwinds Meet External Headwinds: The Market Pulls Back After an Initial Rally

Behind the market's movements was a clash between supportive domestic policies and increasingly unfavorable external developments.

During the first half of the week, domestic policy measures took the lead. On November 2, the People's Bank of China (PBOC), the National Financial Regulatory Administration (NFRA) and the China Securities Regulatory Commission (CSRC) successively convened meetings on the Securities, Funds and Insurance Companies Swap Facility (SFISF) and the relending facility for share buybacks and share purchases, reaffirming the authorities' commitment to market stabilization. Subsequent details showed that applications for the third round of SFISF facilities had exceeded RMB 100 billion, while the relending program for share buybacks and share purchases was moving toward becoming a long-term institutional arrangement. Expectations of additional liquidity injections worth hundreds of billions of yuan consequently gained momentum.

Meanwhile, around November 4, the outcome of the U.S. midterm elections became clearer, with the Democratic Party sweeping both chambers of Congress. As an uncertainty that had already been partially priced in was finally resolved, the outcome initially triggered a rebound driven by improving market expectations.

However, sentiment shifted sharply on Friday following an overnight sell-off in U.S. AI stocks. Markets began to worry that Democratic control of Congress could lead to tighter AI regulation, reduced technology capital expenditure and delays in data center construction. China's A-share computing infrastructure and hardware supply chain, which is closely linked to the U.S. AI industry, came under pressure as a result.

At the sector level, AI applications and media remained the leading investment themes. Short-form dramas, AI-generated films and other related concepts continued to gain traction, with the media sector performing particularly well. Investors continued to seek opportunities in domestic AI applications, where investment narratives are relatively independent of developments in overseas markets.

The second major theme came from electrical equipment and new energy. Solar stocks rallied across the entire industry chain. This reflected both a rotation of capital within growth sectors, from computing hardware toward lower-valued manufacturing and new energy, and a positive sentiment response to the Democratic Party's sweeping midterm election victory.

Meanwhile, a broader style rotation has yet to materialize. On Friday in particular, low-valuation, high-dividend sectors such as utilities, banks, agriculture, forestry and fisheries once again advanced against the broader market, displaying characteristics of defensive positioning.

Overall, last week's rally was primarily a recovery-driven rebound rather than a confirmed trend reversal. Whether the market can establish a sustained upward trend remains to be seen, particularly given the elevated uncertainty surrounding global risk appetite. Looking ahead, a combination of policy measures, including an expansion of the swap facility, the institutionalization of relending for share buybacks and share purchases, the State Council's proposed market stabilization mechanism, and potential stabilization measures involving Central Huijin, suggests that the market currently has a certain degree of downside support.

In terms of market dynamics, we see three potential stages ahead:

Stage 1: Broad-based recovery driven by policy catalysts. The rally on November 4–5 may already have marked the peak of this initial recovery phase.

Stage 2: Repeated tests of technical resistance levels and trading volume. Overseas developments are likely to remain the biggest near-term variable.

Stage 3: Structural differentiation. Only sectors supported by earnings delivery, favorable policies and underlying industrial fundamentals are likely to sustain excess returns.

Friday's market performance may already have provided an early preview of the volatility expected in Stage 2. Before the market transitions into Stage 3, investors will need to make careful selections and distinguish between opportunities worth pursuing and risks worth avoiding. The volatility arising from uncertainty also provides time to reassess positions, prioritize what to let go before deciding what to pursue, and maintain a constructive outlook.

After the Democratic Sweep: A Shift in the Valuation Framework for AI Assets

Overseas markets were also driven by two major developments. First, the November 3 U.S. midterm elections concluded with the Democratic Party sweeping both chambers of Congress, prompting an initial rally as markets priced in the removal of political uncertainty. Second, the same outcome was quickly reassessed in terms of tighter AI regulation and restrictions on data center approvals, triggering the biggest single-day decline in U.S. technology stocks since April 2025.

The stronger-than-expected October nonfarm payrolls report released on Friday further reinforced expectations

that the Federal Reserve might continue raising interest rates. The U.S. dollar rebounded, while Treasury yields remained elevated. Among commodities, crude oil plunged approximately 13% over the week amid expectations following the Democratic sweep and growing optimism surrounding an end to the U.S.-Iran conflict. Gold, after rising earlier in the week, also retreated on Friday.

The Democratic Party's sweeping victory means that it now controls both chambers of Congress, significantly constraining the Republican Party's ability to advance legislation.

From a macroeconomic perspective, interest rates and the U.S. dollar are likely to be the first channels through which the election outcome affects markets, influencing the discount-rate component of asset valuations. The overall implications may therefore be relatively favorable. From an industrial perspective, however, potential changes in policy toward AI data center infrastructure (AIDC), new energy and pharmaceuticals warrant close attention, particularly in the AI sector.

On fiscal policy, Trump's proposals to expand tax cuts and significantly increase government spending are likely to face substantial obstacles. This could help contain the risk of unchecked fiscal deficit expansion, while the Democratic Party is more inclined to raise corporate taxes to fund additional social spending.

In terms of geopolitics and foreign policy, congressional constraints on military and diplomatic actions are likely to increase, while potential defections within the Republican Party could further complicate Trump's position. Trump may also face the prospect of another impeachment attempt. The risk of military action against Iran may therefore decline, although the outlook for the Russia-Ukraine conflict remains uncertain.

On industrial regulation, the Democratic Party is expected to push ahead with the green energy transition and tighter AI oversight. Antitrust enforcement in the technology sector, AI compliance requirements and data security legislation may all accelerate, while environmental restrictions on traditional oil and gas industries are likely to become more stringent.

For equity markets, higher corporate tax burdens and tighter technology regulation could weigh on earnings expectations, increasing pressure on the earnings side of valuations. These concerns may be further amplified by recent worries over AI-related credit risks, making it increasingly important to focus on relatively resilient investment opportunities. Sectors favored by the Democratic Party, including clean energy, ESG-related industries and healthcare, are worth monitoring.

Another possibility also deserves attention. Following their electoral defeat, Republicans may attempt to push through legislation during the final session of the outgoing Congress. Around year-end, Congress could witness an intense fiscal and tax policy battle, with Republicans potentially seeking to push through tax cuts and spending reductions before the new Congress takes office, effectively turning proposals into law before the transition. Iran-related issues could also feature in this political maneuvering. Such developments could generate a short-term market

shock before year-end and represent a potential black swan event.

In recent years, U.S. equity markets have experienced at least one major scare each year, although each episode ultimately proved manageable. In 2024, it was the unwinding of the yen carry trade; in 2025, the reciprocal tariff shock; and this year, the market has already experienced a second major episode of volatility following the U.S.-Iran conflict in the first half of the year. The increasing frequency of these episodes highlights just how much more volatile the market environment has become.

From a medium- to long-term perspective, however, the broader technological revolution is unlikely to have run its course. The AI revolution remains an irreversible trend, and underlying demand for computing power continues to grow. The Democratic Party's sweeping victory may simply accelerate the unwinding of valuation excesses and bring greater discipline to inefficient capital expenditure. A slowdown in data center construction may therefore represent a shift toward more regulated and standardized development rather than a reversal of the underlying investment trend. This will naturally introduce new considerations into the process of stock selection.

If the market's concerns in July marked the beginning of a shift in focus toward cash flow, as the rising reliance on financing to support AI capital expenditure prompted investors to move from evaluating the scale of CapEx to its quality, then the increase in AI-related credit risks in early October pushed the focus further toward whether financing could be matched by future earnings, as well as the operational sustainability and financial resilience of individual companies and entities.

Now, with expectations of tighter regulation and greater discipline over capital expenditure emerging, the ability of downstream AI applications to generate cash flow and feed it back into the industry is being assigned unprecedented importance.

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