China Equity Markets: Not Time to Lose Faith

Summary

- This is a long overdue correction triggered by spike in US yields, concerns over China tightening and increasing regulations on China techs.

- Cyclical and structural factors are in place to drive the uptrend of domestic A-shares, Hong Kong-listed China equities, and select quality tech companies. Weaknesses are good buying opportunities.

A long overdue correction eventually arrives

We mentioned in early February that the market looked overbought and complacent that a correction was long overdue. Hence, the recent correction since mid-February did not come as a surprise to us. Concerns over spike in US yields, tighter China liquidity conditions, tightening in China's property sector, and the anti-trust rules targeting China's tech giants all served as triggers of the recent drawdown.

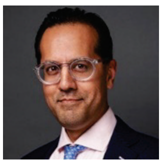
The onshore A-share market, which is largely driven by retail investors, could be even more volatile. This is the major correction for the CSI 300 Index (-15%) since its rebound in March 2020 (+59%). Historical corrections in A-shares tend to take 2-3 months with over 15% drawdowns. We do not expect significant downside from here but the consolidation may take for a while longer with turnover to shrink further in coming weeks. As the domestic stock market is more sentiment-driven, new catalysts are required to boost confidence.

Some areas that worth closely watching are: (1) economic data particularly credit data, (2) upcoming earnings results, and (3) any soothing comments from the PBoC.

No aggressive tightening as no aggressive easing to begin with

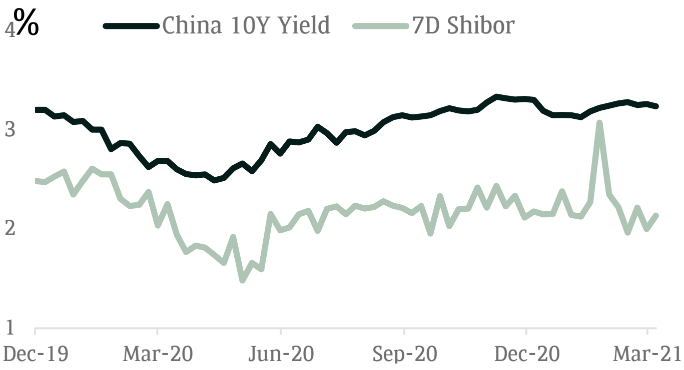
China's economic and earnings fundamentals are expected to continue to improve. There is still a lot of pent up demand to be released going forward, especially in private sector capital

Prashant BHAYANI
CIO Asia
BNP Paribas
Wealth Management



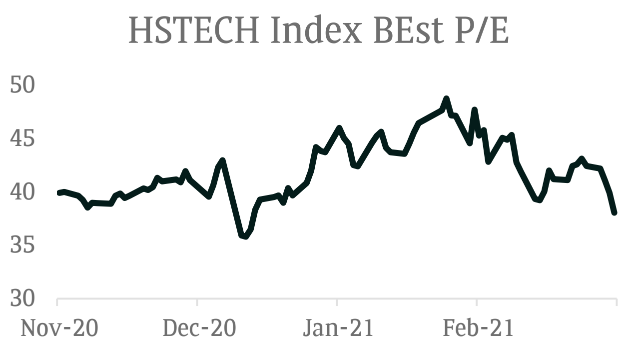
Grace TAM
Chief Investment Adviser
Hong Kong
BNP Paribas
Wealth Management

CHINA 10-YEAR GOVERNMENT BOND YIELDS & 7-DAY SHIBOR HAVE BEEN STEADY



Source: Bloomberg, BNP Paribas (WM), 25 Mar 2021
Past performance is not indicative of current and future performance

HANG SENG TECH INDEX 12-MONTH FORWARD PE RATIO – VALUATIONS BECOME ATTRACTIVE



Source: Bloomberg, BNP Paribas (WM), 25 Mar 2021
Past performance is not indicative of current and future performance

spending and household consumption. The PBoC stressed that there will be no sharp U-turn in monetary policy. In the recent National People's Congress (NPC), one of the key economic targets is for M2 and credit growth to move in line with nominal GDP growth (our estimate is 11-12%, down slightly from 13% last year) to stabilize the debt to GDP ratio.

China did not embark on super easing during the Covid crisis, and hence, the ongoing policy normalization when the economy is recovering with no inflationary threat at the moment would be gradual, except in a certain areas, such as the property sector where the government worries about bubble (administrative measures have been used rather than macro tightening) and some areas in shadow banking where government would allow some non-profitable SOEs to default on their onshore bonds in an attempt to break moral hazard.

There are also no signs of tightening in China's monetary conditions. Despite the sharp spike in US yields, China's government bond yields and interbank rates have stayed steady. The 7-day SHIBOR rate, widely viewed as one of the PBoC's policy reference benchmarks in its interest-rate corridor operations, has eased considerably after the Lunar New Year holiday.

A lot of negative newflows have been priced in China techs

We downgraded Asian tech sector from positive to neutral in early February after the spectacular rally, and we will look for opportunities to upgrade the sector again. While further anti-trust regulatory guidelines to rein in powerful internet platforms is not ruled out in the near term, we believe that the Chinese authorities do not aim curbing the development of internet companies or fully breaking them up given that the platforms bring innovation and digitalization to the overall economy. This is one of the top priorities that had been reiterated during the latest NPC. We believe the aim is to shape a more balanced and competitive landscape to achieve a more sustainable growth.

We also expect the risk has been increasingly priced in and revenue impact on the sector as a whole should be manageable. Hence, the deep corrections offer good re-entry points for medium-term investors to accumulate select, high quality tech names in tranches, particularly in grocery e-Commerce/food delivery, mobile gaming, online entertainment, online travel agency and advertising.

Increasing "new economy" stocks to drive inflows to Hong Kong

Following the inclusion of some "new economy" stocks in the Hang Seng Index (HSI) and the launch of Hang Seng Tech Index last year, which drove significant inflows into the HK stock markets, Hang Seng announced recently the proposed enhancements to the HSI which would further increase weighting to "new economy" sectors (IT, consumer and healthcare) from 44.5% to 52.4%. Some key changes are: (1) to increase the number of constituents from 55 at present to 80 by mid-2022 and to 100 ultimately; (2) to expand representation to 7 industry groups; (3) to shorten inclusion of new listings to 3 months. Overall, these changes not only would attract more advanced companies to listed in HK, but also engage more global asset allocators to track HSI. In addition to the continued "Homecoming" theme with the China ADRs listed in the US returning to HK for secondary listings, we expect significant inflows into HK stock market in the years to come (Hong Kong has seen 29th consecutive week of foreign net inflows as of 19 Mar 2021).

CONCLUSION

Cyclical and structural factors are in place to drive the uptrend of domestic A-shares, Hong Kong-listed China equities, and select high quality tech companies. Weaknesses are good buying opportunities to re-enter the Dragon!

DISCLAIMER

This document is provided in Singapore by BNP Paribas, acting through its Singapore branch, and in Hong Kong by BNP Paribas, acting through its Hong Kong branch. BNP Paribas is a public limited company (société anonyme) incorporated in France with liability of its members limited. BNP Paribas, acting through its Hong Kong branch is a licensed bank regulated by the Hong Kong Monetary Authority, a Registered Institution under the Securities and Futures Ordinance of Hong Kong (Cap. 571), and registered with the Securities and Futures Commission (SFC) to carry on Types 1, 4, 6 and 9 regulated activities in Hong Kong (SFC CE Reference: AAF564). BNP Paribas, acting through its Singapore branch (UEN/Registration No: S71FC2142G), is a licensed bank regulated by the Monetary Authority of Singapore. BNP Paribas Wealth Management is the business line name for the Wealth Management activity conducted by BNP Paribas. "BNP Paribas Wealth Management" (UEN/Registration No 53347235X) is a business name registered in Singapore under the Business Names Registration Act 2014.

This document is produced for general information only and should not be used as reference for entering into any specific transaction, and the information and opinions contained herein should not be relied upon as authoritative or taken in substitution for the exercise of judgment by any recipient or the seeking of independent professional advice (such as financial, legal, accounting, tax or other advice) by any recipient. This document is not intended to be an offer or a solicitation to buy or to sell or to enter into any transaction. In addition, this document and its contents is not intended to be an advertisement, inducement or representation of any kind or form whatsoever. BNP Paribas reserves the right (but is not obliged) to vary the information in this document at any time without notice and, save to the extent provided otherwise in Clause 6.5 of BNP Paribas Wealth Management's Terms and Conditions ("T&Cs") applicable to your account, BNP Paribas shall not be responsible for any consequences arising from such variation.

The terms set forth herein are intended for discussion purposes only and are subject to the final expression of the terms of the transaction, if the investor decides to proceed with the transaction. It does not represent (a) the actual terms on which a transaction would be entered into, (b) the actual terms on which any existing transactions could be unwound, (c) the calculation or estimate of an amount that would be payable following an early termination of the transactions, or (d) the actual valuations given to the transactions by BNP Paribas in its books of account for financial reporting. The final terms of the transaction will be set forth in the final term sheet, any applicable agreement and/or confirmation. Please also refer to the disclaimer statements contained in the relevant documents, and disclosure and other important information concerning our fees, charges and/or commissions as set out in the Fee Schedule.

If this document is a post-trade/transaction confirmation, please examine the information as set out in this document carefully and contact us immediately if you notice any discrepancy. The content of this document is subject to the final transaction(s) details / information in our official bank statements and/or advices (if any) which may follow by mail. This document contains confidential information intended only for the use of the addressee(s) named above. If you are not the addressee(s), you must not disseminate, copy or take any action in reliance on it. If you have received this document by error, please notify BNP Paribas and delete/destroy this document immediately.

Although the information and opinions provided herein may have been obtained or derived from published or unpublished sources considered to be reliable and while all reasonable care has been taken in the preparation of this document, BNP Paribas does not make any representation or warranty, express or implied, as to its accuracy or completeness and, save to the extent provided otherwise in Clause 6.5 of the T&Cs applicable to your account, BNP Paribas shall not be responsible for any inaccuracy, error or omission.

All analysis, estimates and opinions contained in this document constitute BNP Paribas' own judgments as of the date of this document, and such expressions of opinion are subject to change without notice. Information provided herein may contain forward-looking statements. The words "believe", "expect", anticipate", "project", "estimate", "predict", "is confident", "has confidence" and similar expressions are also intended to identify forward-looking statements. These forward-looking statements are not historical facts but based on the current beliefs, assumptions, expectations, estimates, and projections of BNP Paribas in light of the information presently available, and involve both known and unknown risks and uncertainties. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond control and are difficult to predict. Consequently, actual results could differ materially from those expressed, implied or forecasted in these forward looking statements. Investors should form their own independent judgment on any forward-looking statements and seek their own advice from professional advisers to understand such forward-looking statements. BNP Paribas does not undertake to update these forward looking statements.

DISCLAIMER

Where investors take into account any theoretical historical information regarding the performance of the product/investment, investors should bear in mind that any reference to past performance should not be taken as an indication of future performance. BNP Paribas is not giving any warranties, guarantee or representation as to the expected or projected success, profitability, return, performance, result, effect, consequence or benefit of any investment/ transaction. Save to the extent provided otherwise in Clause 6.5 of the T&Cs applicable to your account, no BNP Paribas group company or entity therefore accepts any liability whatsoever for any loss arising, whether direct or indirect, from the use of or reliance on this document or any part of the information provided.

Structured transactions are complex and may involve a high risk of loss including possible loss of the principal invested. If any product mentioned in this document is a structured product which involves derivatives, do not invest in it unless you fully understand and are willing to assume the risks associated with it. If you are in any doubt about the risks involved in any product/transaction, you should seek independent professional advice.

Prior to entering into any transaction, each investor/subscriber should fully understand the terms, conditions and features of the product/investment as well as the risks, the merits and the suitability of entering into any transaction/investment including any market risk associated with the issuer, and consult with their own independent legal, regulatory, tax, financial and accounting advisors before making the investment. Investors/subscribers should fully understand the features of the investment, be financially able to bear a loss of their investment and be willing to accept all risks involved. Save as otherwise expressly agreed in writing, (a) where BNP Paribas does not solicit the sale of or recommend any financial product to the investor/subscriber, BNP Paribas is not acting as financial adviser of the investor/subscriber in any transaction, and (b) in all cases, BNP Paribas is not acting as fiduciary of the investor/subscriber with respect to any transaction.

BNP Paribas and/or persons associated or connected with it may effect or have effected a transaction for their own account in a product/an investment described in this document or any related product before or after this document is published. On the date of this document, BNP Paribas and/or persons associated or connected with it and their respective directors and/or representatives and/or employees may take proprietary positions and may have a long or short position or other interests or make a market in a product mentioned in this document, or in derivative instruments based thereon, and may purchase and/or sell the investment(s) at any time in the open market or otherwise, whether as principal or as agent or as market maker. Additionally, BNP Paribas and/or persons associated or connected with it may have within the previous twelve months acted as an investment banker or may have provided significant advice or investment services to the companies or in relation to a product mentioned in this document.

This document is confidential and intended solely for the use of BNP Paribas and its affiliates, their respective directors, officers and/or employees and the persons to whom this document has been delivered. It may not be distributed, published, reproduced or disclosed by any recipient to any other person, nor may it be quoted or referred to in any document, without the prior written consent of BNP Paribas.

Hong Kong: This document is distributed in Hong Kong by BNP Paribas, acting through its Hong Kong branch only to Professional Investors within the meaning of Part I of Schedule 1 to the Securities and Futures Ordinance of Hong Kong (Cap. 571). The products or transactions described in this document may not be authorised in Hong Kong and may not be available to Hong Kong investors.

Singapore: This document is distributed in Singapore by BNP Paribas, acting through its Singapore branch only to Accredited Investors within the meaning of the Securities and Futures Act, Chapter 289 of Singapore only and is not intended for investors in Singapore who are not such Accredited Investors and should not be passed on to any such persons. Some products or transactions described in this document may not be authorised in Singapore and may not be available to Singapore investors.

Save to the extent provided otherwise in Clause 6.5 of the T&Cs applicable to your account, information in this document is for general circulation to the intended recipients only and is not intended to be a recommendation or investment advice to recipients hereof. A recipient of this document should seek advice from its/his/her own professional adviser regarding the suitability of the products or transactions (taking into account the recipient's specific investment objectives, financial situation and particular needs) as well as the risks involved in such products or transactions before a commitment to purchase or enter into any product or transaction is made.

Please note that this document may relate to a product or products where BNP Paribas is issuer, and in such instance this document or certain information contained therein may have been prepared by BNP Paribas in its capacity as product issuer ("Issuer Document"). Where an Issuer Document is provided to

CONNECT WITH US

wealthmanagement.bnpparibas/asia

GENERAL DISCLAIMER

you by BNP Paribas, acting through its Hong Kong branch or BNP Paribas, acting through its Singapore branch in its capacity as distributor, it shall also be subject to Clause 6.5 of the T&Cs. To the extent that there are any inconsistency between the terms of an Issuer Document and Clause 6.5 of the T&Cs, the latter shall prevail. Generally, please take note that various potential and actual conflicts of interest may arise from the overall investment activities or the roles of the parties involved in any investment product or transaction, their investment professionals and/or their affiliates. In particular, the counterparty / issuer / provider or its related entities or affiliates can offer or manage other investments which interests may be different to the interest of your investments in that investment product or transaction; or for cases where the product counterparty or issuer is BNP Paribas or its related entity or affiliate, BNP Paribas may also act as distributor, guarantor, calculation agent and/or arranger of the same product.

BNP Paribas and its affiliates and persons associated or connected with it (collectively "BNP Paribas Group") may make a market in, or may, as principal or agent, buy or sell securities mentioned in this document or derivatives thereon.

BNP Paribas Group, including its officers and employees may serve or have served as an officer, director or in an advisory capacity for any issuer mentioned in this document. BNP Paribas Group may, from time to time, solicit, perform or have performed investment banking, underwriting or other services (including acting as adviser, manager, underwriter or lender) within the last 12 months for any issuer referred to in this document. BNP Paribas Group may, to the extent permitted by law, have acted upon or used the information contained herein, or the research or analysis on which it was based, before its publication. Members of the BNP Paribas Group may face possible conflicts of interest in connection with certain duties under structured products. For example, it and its affiliates may trade an underlying for their own account or for the account of others. It or its affiliates may receive a portion of the management or other fees charged with any of the underlyings. BNP Paribas may offer other services to entities associated with an underlying, for which they may be remunerated. All of these activities may result in conflicts of interest with respect to certain financial interests of BNP Paribas.

Where this document includes a reference to real estate, please note that real estate service offered in Hong Kong by BNP Paribas, acting through its Hong Kong branch exclusively relates to real estate properties outside Hong Kong. Specifically, BNP Paribas, acting through its Hong Kong branch is not licensed to deal with any real estate property situated in Hong Kong. BNP Paribas, acting through its Singapore branch is not licensed to and does not offer real estate service, and nothing herein should be construed as such.

By accepting this document, you agree to be bound by the foregoing limitations. In case there is a Chinese version and there is any ambiguity or difference of meaning between the English version and the Chinese versions, the English version shall prevail. In respect of any transactions or arrangement with BNP Paribas, acting through its Singapore branch, the English version is the only operative version and the Chinese version shall be disregarded.