Fund Manager Perspective

June 2017

Stock Market

A shares are finally included in MSCI index. As this issue has been discussed for many times, the market was most calm before the inclusion. However, shortly before and after the inclusion, the A-share index maintained the uptrend. With only 5% to be calculated as the weight this time and the inclusion to officially start in May 2018, there was little impact on the money supply in the current stage, but the market has taken into full consideration the expectation for long-term impact, which was slightly beyond our expectation.

The tightening up of entrusted investment by banks triggers market adjustments, but the intensity is lower than expected. As banks obviously tightened up their entrusted investment since May, we estimated that its impact would at least last till the end of the 2nd quarter. However, there's almost no negative effect on the market in June.

The style and trend of the market will remain, with changes expected. The inclusion of A shares into the MSCI index has caused the market to continue to pursue blue chips. However, we believe that most of the growth stocks in the portfolio are far more attractive than the blue chips in terms of investment value. We expect that changes may occur to the market style, though there are no significant signals at present.

Bond Market

Financing Function of Bond Market yet to be restored

Core viewpoint: This year the financing function of the bond market has dwindled significantly, which represented the cost of financial deleveraging in a sense. But with the initial results achieved in deleveraging coupled with the in-balance-sheet credit line gradually depleted, it is urgent to restore the financing function of the bond market. In the context of the recent iconic events including the launch of the "Bond Connect" and the issuance of the No. 1139 Document of the National Development and Reform Commission, the policy is expected to continue to maintain the moderate tone, leaving the bond market with a space for more increases, but the pace is more likely to slow down compared with June.

Since the beginning of this year, the social financing structure has undergone great changes, mainly represented by sharply shrinking direct financing and remarkably increasing indirect financing, with the significantly declining net amount of bond financing as the main reason for the structural changes. From January to May this year, the net financing amount of corporate bonds was RMB-348.9 billion, representing the first time in history to record such sharp decline in bond financing, and even in 2013 with significantly high yields, the net bond financing amounts were continuously positive. There were two main reasons behind the phenomenon. First, the substantial increases in the cost of bond financing made some enterprises with relatively relaxed bank credit turn to credit financing. Second, the enterprises obtained large amounts of funds through low-cost issuance of bonds in the past two years, resulting in the comparatively light pressure for refinancing. However, the above two factors are not sustainable in the medium term. First of all, the bank credit is often characterized by higher availability followed by the lower, which means that the issuance in the first half of the year would be more than that in the second half. Therefore, it would be more difficult for the enterprises to get loans from the banks in the second half of the year, and in addition, the micro-feedback shows that some banks have nearly used up the credit line for the whole year. Secondly, there is high pressure for the maturity of the bonds in the second half of the year, especially in August when the credit bonds to be repaid reach the annual high of RMB556.5 billion, putting higher pressure on the enterprises in refinancing through bonds.

With the urgent need to restore the financing function of the bonds compared to the still high costs of bond financing, the current contradiction is becoming more prominent. Behind the contradiction is actually the game relationship between the deleveraging and stabilizing growth. In addition to the increasing natural interest rates resulted from the improved economic fundamentals, the external shock formed by financial deleveraging also played a significant role in keeping the bond financing costs at a high level. In a sense, the declining net amounts of bond financing are part of the cost for financial deleveraging. However, the continued decline in the net bond financing amounts constitutes a downward pressure on the economy. This reaction is gradually taking place, as in recent months the growth rates of the capital sources for fixed asset investment have been continuously sluggish, and the number of the enterprises reporting difficulty in financing in the June PMI survey was also increased, showing that the difficulty in financing has expanded its negative impact on the economic growth at both the macro and micro levels. Therefore, in the current stage the balance between deleveraging and stabilizing growth is expected to be fine-tuned, which means that considering that initial results have been achieved in deleveraging, the decision makers will attach more importance to stabilizing growth.

In addition, the two noteworthy events in recent days, namely, the launch of the “Bond Connect” and the issuance of No. 1139 Document of the National Development and Reform Commission, are the positive factors for restoration of the financing function in the bond market. The former was mainly designed to attract overseas funds to invest in the mainland bond market and bring incremental funds to the bond market at the demand level. Despite the incremental funds expected to be limited in the short term, the policy significance cannot be ignored. The latter is mainly to reduce the social costs, with reduction of costs for social financing especially proposed, and the statement of “continue to expand the scale of bond issuance, and advance the external development of the bond market” is directly related to the financing function of the bond market. Therefore, in my opinion, it has been gradually of policy significance to restore the net financing function of the bond market, and in the process both the monetary policy and the regulatory policy will see the continuously tightening space narrowed.

In terms of the strategies on the bond market, considering that a relatively moderate attitude will be maintained in policy, the market still has the foundation for increases, but the upward impetus is more likely to decline compared with June. There are three main negative factors. The first is the concern that the money supply will be tightened again, the second is the pressure on redemption from the entrusted investment after maturity, and the third is the impact of the fundamentals data beyond expectation. All the three factors are likely to have the negative impact on the bullish sentiment on the market. But so long as the monetary policy and the regulatory policy maintain a moderate tone, the driving force for increases in the bond market will still exist, and at least the market trend of valuation restoration will continue, with the interest rate spread of high-grade credit bonds against the loans expected to narrow further.