Fund Manager Perspective

March 2018

Stock Market

Growth stocks were ultra-buoyant in March. With the market fluctuations sharply expanded and the market trend poising for a shift in February, the growth stocks remarkably outperformed the blue-chip stocks in March, with the substantial drops of the blue chips compared with the significant increases of the growth stocks. We are sure that the market trend has shifted and in the future the mainstream investment products in the market will be the growth stocks, conforming to the long-term trend of the Chinese stock market.

Exploring the structural opportunities for growth stocks. As the Two Sessions stressed that China's economic growth depends on new driving forces, we can tap into the opportunities for business development and corporate growth resulted from a series of "innovations" such as emerging industries, new business models and new consumption upgrading. In particular, with the rapid development of the mobile Internet at present, new businesses and new models emerge in large numbers, and the outstanding emerging companies are growing in a more and more rapid way, resulting in high expectation.

The pharmaceutical and medical-care stocks will continue to show a strong uptrend. In 2017, the comprehensive consumer stocks performed well. However, with overall profitability impaired because of China's medical system reform, the pharmaceutical and medical-care stocks recorded a poor performance in stock prices. In this process, the outstanding companies with substantial competitiveness still achieved sustained and rapid growth in profits, such as Lepu Medical, Tonghua Dongbao, Meinian Onehealth and Realcan Pharmaceutical in our portfolio, which have caused the pharmaceutical and medical-care sector to be sought after recently. We expect that in 2018, the marginal negative impact of the medical reform on the pharmaceutical and medical-care industry will gradually disappear, and the industry will increasingly be favored by the investors.

Bond Market

In March 2018, the yields went down significantly. Affected by the relaxed money supply the short-term yields extended the downtrend, and with the falling commodity prices coupled with the declining short-term yields, the long-term yields recorded significant drops. The yield curves moved downward remarkably on the whole. In terms of the net value, the long-term bonds outperformed the short-term bonds markedly.

The expectations of the monetary policy are differentiated. The falling yields in the month were mainly driven by the rapidly declining short-term interest rates. The downside of the short-term interest rates reflected the changes in the money supply, and also altered the market's expectations of the monetary policy. The main reasons for the differentiation include: (1) The deleveraging process has been going on for more than a year, and in the future its strength will diminish marginally, as recently, some central bank officials have said that the deleveraging effect has already been felt and in the future the policy intensity will not be stronger than the current period; (2) Since March, the money supply has continued to be relatively relaxed. The loose capital supply was reflected by the interest rate of interbank deposits rapidly declining to approach the 2017 low as well as the 3-month Shibor interest rate also dropping speedily. However, the central bank has not shown the intention to tighten the market; (3) The Fed raised interest rates. The market had expected that the central bank would follow suit to adjust the interest rates in the open market, but the MLF was only increased by 5 bp, which was lower than the common expectation of 10 bp in the market. The money supply was tightened less than expected, raising the question about whether the monetary policy will be shifted.

The decreasing interest rates outside China have played a significant driving role. This month, the Federal Reserve raised the interest rate by 25 bp, which basically met the expectations. However, there is still the market view that the expectation for the rounds of the interest rate hikes in 2018 is too dovish. Therefore, after the interest rates were increased, the bond yields declined instead of rising with that of the 10-year US Treasury Bond shrinking by 8bp at the most. The global bond market did not see the long-term interest rates go up in the context of the climbing short-term interest rates, and the domestic bonds followed the trend of global interest rates.

The fundamentals show the downward pressure. From a historical point of view, the change to the trend of the 10-year Government Bond yield mainly depends on two factors, including the economic fundamentals and the capital prices, both of which are necessary. The judgment of the fundamentals is mainly based on the observation of the nominal GDP, which includes changes in both actual quantities and the price factors, reflecting the level of interest rates that the rates of return at the entity enterprises can bear. The judgment of the capital prices can be achieved mainly through the observation of the 3-month Shibor interest rate. The capital prices indicate not only the liquidity situation itself but also the tendency of the monetary policy, and the monetary policy shall take into account not only the factor of the fundamentals but also the regulation and other non-fundamentals elements. In the second half of 2013, for example, the growth rate of the nominal GDP was relatively stable, which means that the fundamentals did not support a sharp rise in the yield, but the 3-month Shibor interest rate showed a rapid upward trend, significantly driving up the long-term interest rates. It indicated that the main driver for the bond crisis was the deliberately tightened monetary policy under the strict regulation, and the following drops in the long-term interest rates were accompanied by the downtrends of the fundamentals and money supply. Observing the bond market since 2017, we find that the nominal growth rate of GDP peaked in February 2017, implying that the fundamentals had not supported the further increases of the yields at the beginning of the year, but in fact, the yields went up remarkably in the whole year, during which period the trend of the 3-month Shibor interest rate was highly indicative as its high of the year appeared at the end of 2017.

In summary, the yield pivot of the bond market has declined significantly. However, it is still hard to confirm the downward trend in interest rates. (1) It is difficult to affirm whether the monetary policy will be shifted. As after the Two Sessions in March, new Governor Yi Gang and Party chief Guo Shuqing of the Central Bank just took office, it takes time to set and implement the policy orientation for the future. In addition, as the proposal of “preventing and defusing the financial risks” at the National Economic Working Conference has not been changed and has been put in the first place, it is likely to extend the relatively tight monetary policy in the past. (2) The market expects that the “new rules for asset management” will be soon be issued, which will have a huge impact on both the wealth management market in a current size of RMB 30 trillion and the bond market. It is difficult to judge how it will affect the market before it is officially released. We still have to wait for its publication so as to assess its impact.