智盈 多元资产绝对收益策略
Plutus Multi-Asset Absolute Return Strategy (MARS)

SERESIA

Investment Outlook – 4Q 2020

SUMMARY – A fresh new business cycle is playing out in China and we are still at the initial recovery stage of a cyclical bull market in Chinese equities. Leading indicators have turned up and long bond yields have bottomed for a few months, even though earnings revision trend has slipped again in Sep. China's macro policy easing since 2Q have facilitated a board-based economic recovery but there is still room to roll out more incremental stimulus amid the drag in global recovery because of the second wave COVID-19 outbreaks in US and UK/Europe since July/Aug. Looking ahead, more evidences of earnings acceleration and an easing of Sino-US political tensions will support Chinese equities further and could reverse the negative outflows of China funds. Finally, the huge valuation dispersion between Growth and Value stocks does signal long-term opportunity for value investors.

Business Cycle & Macro Backdrops

Business Cycle – As China gradually ended the lockdowns in March, the post-pandemic recovery has been in full swing since 2Q and the overall economic activity has re-entered the positive territory recently on a YoY basis. Strong manufacturing and export activities were leading the recovery whereas trade growth/industrial production are likely to remain strong in the coming months. However, retail sales and FAI recovery were relatively sluggish until very recently. The good news is that consumption activities seems to have strengthened further from Aug onwards and business confidence have improved as well. Previously hard-hit sectors such as restaurant and leisure industries have also shown signs of improvement since Sep.

Fiscal Policy – China has relied mainly on tax cuts and infrastructure spending as the key measures to support growth. Given the high national saving rate and a reasonable government debt level, this year's high fiscal deficit is still managing. While property policy was loosened selectively in many cities earlier this year, policy makers are still concerned over the potential of an overheated housing market. Thus the focus remains on introducing more capital market reforms and liberalization measures as Chinese leaders prefer to trade off short-term GDP growth with more sustained productivity gains over the longer term. We believe the potential of further fiscal stimulus package has reduced unless growth risk resurfaces and the pace of recovery stalls again.

Business Cycle & Macro Backdrops (cont.)

Monetary Policy – Although the PBoC has adopted accommodative monetary policy to support the economic recovery, the last rate and RRR cuts were implemented some 5 months ago. Indeed, SHIBORs have increased notably since June and we think the PBoC may have underestimated the rising credit demand, especially among many cash-strapped SMEs. While total social financing has reached 13.4% yoy (mostly because of special bonds issuances) in Aug, M2 and credit growth were still below the levels we saw in previous early recovery phases. As food inflation moderates further, we believe there are still rooms for incremental easing. But the reluctancy of adopting more broad-based monetary stimulus have led us to reduce exposure on rate sensitive counters.

External Backdrops – The Fed opened-ended QE plus the aggressive easing by other major central banks have provided enormous global liquidity and stabilized the world economy. The severe shortage of US$ was over and the crisis management phase of central banking has recently been replaced by incremental easing. Looking beyond the US Election, we believe US$ may weaken further as US economic recovery is likely to lag behind many other regions and the issue of massive fiscal deficits will have to be addressed. We think China's better relative growth outlook and positive interest rate spreads over the US should underpin a strong Rmb into 2021.

Yield Curve – China long bond yields have gone up significantly since their lows in late Apr on the back of macro policy stimulus. Instead of having a steepening yield curve that one would normally expect at this point of the economic cycle (recovery), the spread between 10-year and 1-year bond has narrowed from 130bps 6 months ago to about 50bps recently. The short-end of the China yield curve has gone up too rapidly and short-term interest rates have unusually escalated. We thus see better relative value on short-term China sovereign bonds.

Earning Outlook – After more than 2 years of deceleration, consensus earnings have bottomed in 2Q and industrial profits growth has accelerated for four consecutive months. The slowing pace of improvement since August has hit the performance of Value/Cyclical stocks lately even though the worst of negative earning downgrades for Corporate China was behind us. We believe earnings revision would remain the key driver for the rotation away from over-owned Growth stocks into Value/Cyclical plays.

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Business Cycle & Macro Backdrops (cont.)

Valuation – Despite the rally in Chinese equities in the past 6 months, valuation are still well below the historical means in most measures (PER, P/BV, dividend yield, etc). As the worst of the earnings downcycle is behind us, we expect equity risk premium to fall gradually as the economic activities will normalize in the coming quarters. However, domestic liquidity condition may not improve much given the reluctancy of more macro easing, we need further sequential earnings improvements to help restore values on oversold counters. Longer term, foreign fund flows could return to Chinese equities once a vaccine will be made available, which will restore global investors' confidence of a sustained China recovery into 2021 and encourage further inflows into Rmb denominated assets.

Investment Views & Quarterly Adjustments

	Negative	Neutral	Positive	Change
SECTOR				
Financials			⑤	
Real Estate			④	↓
Energy & Materials		③		↓
Industrials		③		↓
Consumer Discretionary			④	↑
Information Technology			⑤	↑
Communication Services		③		↑
Healthcare	①			
Consumer Staples	①			
Utilities	①			
STYLE				
Large Gap			⑤	
Mid Cap		③		
Growth			④	↑
Value			⑤	
Interest Rate Sensitive		③		↓
Cyclical		③		↓
Income	②			
Defensive	①			

** ① being most Negative and ⑤ being most Positive*

Tactical Allocation – 4Q 2020

Stock Attributes Matrix – The slowdown in the global and Chinese economy in 2019 and the COVID-19 outbreak since 1Q20 has facilitated a prolonged outperformance of Growth stocks. Given the material mis-pricings in many Value counters, we have adopted a dual-overweighted "Growth plus Financials" barbell-approach of portfolio construction to take advantage of a post-pandemic recovery. While this have served us well since March, the valuation dispersion between Growth and Value stocks is simply too extreme on a historical context. We believe we are close to the inflection point to expect relative outperformance of Value stocks against over-owned and over-valued Growth stocks, possibly after the US Election Day and/or when a vaccine will be available. We will look to trim our Growth stocks to a neutral stance in favour of some under-appreciated Value and Cyclical industry leaders before the year end. Meanwhile, factors like Size (Big over Small) and Balance Sheet (Strong over Weak) could continue to deliver positive returns until we enter the expansion stage of this new business cycle.

Sector Allocation – We are overweighting Chinese 'Big Tech' with interesting thematic growth outlook and strong execution track records. We have also added Consumer Discretionary exposure lately as consumer confidence sets to recover gradually over time. Since the PBoC has proved to be reluctant to ease further, we have decided to cut the weighting on rate sensitive stocks. We are also looking to add Leisure and Aviation stocks upon the news of successful phase-3 vaccine trials and would remain selective on counters that offer attractive long-term risk-return trade-off, especially among Industrial, Material, and Energy sectors. Finally, we see distinct value/mispricing opportunities on a few big Financial franchise names for more patient investors, who could look beyond 4Q performance.

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