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Plutus Multi-Asset Absolute Return Strategy (MARS)

SERESIA

Quarterly Investment Outlook – 1Q 2021

SUMMARY – This new bull market in Chinese equities has been supported by the fresh business upcycle that started last March. Given the ample liquidity condition, supportive policy backdrops, and positive earnings revisions ahead, 2021 could potentially offer the best yearly return for Hang Seng Index in this upswing. While many advanced economic indicators are pointed to further growth acceleration ahead, both services sectors and real urban residents' disposal income growth are still lagged the trend of GDP recovery. Thus, we do not rule of the potential for more policy stimulus in 2Q21 if the lackluster income growth or other external risks do weigh on consumption recovery, especially as inflation is unlikely to be a policy issue this year. Until then, the current stock market rally could come to a pause until we see further evidences of growth/earnings acceleration and/or the new round of policy supports.

Business Cycle & Macro Backdrops

Business Cycle – Manufacturing and exports have been the two pillars for this sharp economic recovery. Together with the slow normalization of consumer spending, economic output has returned to its pre-COVID level last Nov. While we are confident that this recovery can be sustained in the coming months, we would also flag the importance for the momentum of domestic FAI and consumption recovery to pick up ahead especially if the exports-driven manufacturing acceleration may lose steam in early 2021. We are skeptical on the almost 9% real GDP consensus growth rate for China. However, we believe the duration of this upcycle could surprise on the upside. Specifically, the Chinese government has drawn plans to drive technology and consumption upgrades to achieve a more balanced, sustainable and higher-quality growth over the long-term. This could help to extend this economic expansion to beyond 2022.

Fiscal Policy – Unlike previous downturns, China had relied mostly on tax cuts and government spending as the key measures to revive the pandemic-hit economy last year. Given the high national saving rate and a reasonable central government debt level, the higher short-term fiscal deficit is still manageable. Before external demand have been fully recovered, there are rooms for allowing more incremental fiscal stimulus to safeguard against any growth slippage. China's focus on introducing more capital market reforms and industry liberalization measures to drive long-term productivity growth remain unchanged.

Business Cycle & Macro Backdrops (cont.)

Monetary Policy – In order to balance the long-term objective to reduce the overall Debt/GDP ratio with the needs to combat a recession, policymakers only adopted a mildly accommodative monetary policy to support the economy. In fact, PBoC only cut the 1-year prime lending rate by 40bps so far. Moreover, money supply and credit growth last year were significantly lower than the levels we saw in previous downturns. SHIBORs had also increased notably between last July and Nov amid what we believe to be a pre-matured policy tapering. Since inflation rate has reached its cyclical low only very recently, we believe there are still rooms for incremental monetary easing at least in 1H21.

External Backdrops – The Fed opened-ended QE plus the aggressive easing by other central banks have provided enormous global liquidity and stabilized the world economy last year. The massive flood of printed US$ represented the crisis management phase of central banking but it will be replaced by more incremental easing ahead. While the new Biden government will enact new economic stimulus, there is not much more the Fed/ECB can do. Instead, the handling of the health crisis and the effectiveness of vaccination globally would be the keys ahead.

Yield Curve – While China bond yields have gone up significantly since the late April lows, the treasury yield curve had flattened by 125bps between June and Nov last year as the short-end of the yield curve has gone up too rapidly. As inflation rate has fallen the most of last year, short-term real interest rates have become unusually escalated at the beginning of this recovery. Although the better relative growth performance and the widening real interest rate differential help RMB to appreciate against the US$, the stronger currency and rising interest rates have created some unintended tightening impacts.

Earning Outlook – After 2 plus years of deceleration, consensus earnings have bottomed in 2Q20 and industrial profits growth has accelerated for 7 consecutive months from the trough. We believe the worst of earnings downgrades for Corporate China was behind us, but we have yet to see positive earning revisions outside of industrial sectors. In the absence of significant declines in credit and service inputs costs that one would expect in a typical recession, we may have to wait for stronger topline growth to drive earnings rebound as this economic recovery become more advanced later this year.

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Business Cycle & Macro Backdrops (cont.)

Valuation – Despite the rally in Chinese equities since March, valuation is still 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 economic activities will be normalizing in the coming quarters. But liquidity condition may not be enough to sustain further earning multiple expansion as MSCI China/CSI300 EPS Integers have dropped by about 4% since their late Nov peaks. Yield Curve has also flattened along with rising real rates in the past few months. These are rather unusual developments in an early recovery stage. So near term valuation upsides may rely mostly from positive liquidity conditions and the market could be vulnerable to any renewed growth scare.

Investment Views & Quarterly Adjustments

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

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

Tactical Allocation – 1Q 2021

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. But if the consensus is mostly right about a strong recovery in 2021, growth factor is no longer a scared commodity like it used to be. Moreover, we also see the valuation risk on Growth stocks from rising bond yields (or inflation risk premium) once the post-COVID recovery will be on a more solid footing later this Summer. Thus, we are cutting Growth stocks exposure to a more neutral stance in favour of Cyclical, Income/Yield, and Rate Sensitive counters. Momentum used to a positive return driver but it has been less consistent in recent months. Meanwhile, factors like Size (Big over Small) and Balance Sheet (Strong over Weak) could continue to deliver positive returns (although less so than last year) until we enter the Expansion stage of this new business cycle in China. Probably sometimes next quarter, we would also increase Mid-Cap stocks exposure.

Sector Allocation – We have been reducing some excessively priced Technology and Consumer growth stocks into the new year. Since we think investors are too aggressive on their 2021 global/China growth forecasts especially towards 1H21, we are also scaling back our Energy & Materials stocks exposure to a more neutral stance. Tactically, we would prefer Financial, Real Estate, and Industrials as most are trading at their lowest valuation that we have not seen in many years. The obsession in growth stocks since mid-2018 have many investors abandon defensive Chinese Utilities sand Telecom stocks almost completely; we now see good tactical value on selected big names. We also look to add Leisure and Aviation stocks in Feb/Mar once we have better understanding on the effectiveness of vaccination and their impacts on cross-border travelling.

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