ENGLISH HIGHLIGHTS

Links between Chinese and US markets - A macroeconomic perspective

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Fundamentals of Chinese and US economies diverging; the US is accelerating monetary tightening, while China is still working to stabilize growth. Unlike the start of the previous rate hike cycle, the US economy features faster economic growth, a stronger job market and a higher inflation rate at this point. Therefore, the Fed's monetary tightening cycle could be more aggressive this time than last, and by basing our estimates solely on the previous tightening cycle, we could underestimate the intensity of the new tightening cycle. On the other hand, China has clarified its goal of stabilizing economic growth. China has adopted an accommodative monetary policy and is gradually ramping up its expansionary fiscal policy. The CICC macro index system shows that the Chinese economy may have just passed the first stage (easing of financial conditions) and is hovering in the second stage (recovery of real estate and orders). The domestic economy has not yet entered the third stage (recovery of some early cyclical industries), or the fourth stage (broad-based recovery in production, domestic and external demand, and prices).

Against the background of divergent economic fundamentals in China and the US, in the bond market, long-term interest rates post mixed performances reflecting the impacts of economic fundamentals; in the equity market, however, prices of growth stocks have declined in both China and the US. Since December 1, 2020, yield on China's 10-year government bonds has edged down 4bp, whereas US 10-year Treasury yield has risen 49bp. Although yields on long-term bonds posted divergent performances in China and the US, prices of growth stocks in both the A-share and US stock markets declined, with the SYWG High P/B Index (SYWGHPB), the ChiNext index, and the NASDAQ Composite Index all posting declines of more than 10% since December 1, 2021. Higher-than-expected inflation rate and faster-than-expected monetary tightening in the US has led to shrinking risk appetite, weighing on US growth stocks. In China, as effects of pro-growth policies remain unclear, and the government still needs to ramp up monetary and fiscal easing, concerns over China's economic growth prospect have also dampened stock investors' risk appetite.

More importantly, we have four key observations. 1) From the time perspective, as the proportion of shares held by foreign investors trends up, A-share growth stocks' correlation with the NASDAQ Composite Index has become tighter. 2) From the perspective of cross-sectional analysis, performances of composite indexes for industries where the proportions of shares held by foreign investors are relatively high are closely related to that of the NASDAQ Composite Index. 3) Since the beginning of the year, the performance of growth stocks, to which foreign investors have relatively large exposure, has been lackluster compared to value stocks. 4) In the past one month, although there is no significant foreign capital outflow in aggregate terms, growth stocks witnessed considerable capital outflow.

So how to understand the links between China and US markets? The main factor that affects the links between Chinese and US bond markets is fundamentals (e.g., economic growth, inflation, and liquidity). However, more specifically, which factors drive the interconnection between growth-style stocks in Chinese and US equity markets? In our view, multiple factors could facilitate the links between Chinese and US markets, including: 1) switches between value and growth styles under global asset allocation strategy; 2) establishment of balanced portfolios across different regions under global asset allocation strategy; and 3) investor sentiment contagion across different markets, which might tend to be self-reinforcing.

Looking ahead, US market corrections are not necessarily over, and we suggest watching the US market's potential spillover effects on the Chinese market. Given the relatively sound economic fundamentals in the US and persistently high inflation rate, the Fed could accelerate the pace of monetary tightening, and we cannot exclude the possibility that 10-year US Treasury yield could break above 2.5% in risky situations. In addition, despite the sound economic fundamentals in the US, the possibility of accelerated GDP growth on sequential basis is not high, and PMI is unlikely to keep rising. Despite the sequential rise in interest rates in the US, economic momentum is slowing on a sequential basis, and we believe investors should closely track the US market's potential spillover effects on its Chinese counterpart, especially at critical moments. **We note that asset prices in the technology industry are correlated to the macroeconomy to a certain extent, and we use growth and credit spread data to construct a model, which makes allowances for risk premium of related industries in China and the US, and is thus helpful for assessing risks associated with short-term fluctuations.**

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For analyst certification and other important disclosures, refer to the Disclosure Section.

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