Market Watch

China: More weakness to come?

Summary

- Chinese equity markets have corrected 7% from their July 13th peak culminating in a 4% drop on Friday 24 July.
- US-China tensions have increased with both sides forcing the closure of a consulate in their respective countries.
- Over the past two weeks, China's state media outlets have started highlighting the risks of investing as they engage in a delicate balance of signalling the merits of stock market investing, as well as the perils of leveraged speculation.
- **Our net assessment:** The outlook is for continued state support for equity markets, but not for untamed speculation. This is supportive of our view that Chinese equity markets, on-shore and off-shore, are likely to outperform within Asia ex-Japan.

Background

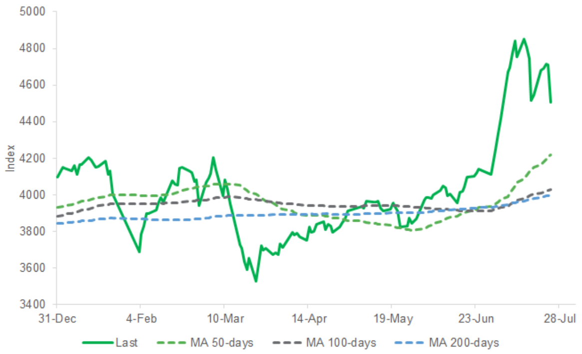
- The deterioration in relations reflects a combination of the long-term increasing rivalry, as China's rise threatens the US's super-power status, as well as the upcoming US presidential election in November. Faced with deteriorating support at home, President Trump appears to be campaigning on 'tough on China' and 'law and order' mantras.
- A part of China's response has been to encourage home-grown technology companies faced with the threat of delisting in the US to pursue a dual-listing in Hong Kong/Shanghai. This policy has seen a number of high profile IPOs list on the Hong Kong exchange and culminated in China's leading chip manufacturer dual list its shares in Shanghai on 16th July. Each listing has seen a large one day "pop" in share prices, with the chip company tripling in value from its IPO price.

What does this mean for investors?

- The approach of the US President election in November is likely to result in increased fluctuations in China, as well as global, stock markets. US Secretary of State Pompeo has been delivering very hawkish speeches denouncing China as an unstable partner. While the speeches have been roundly condemned, such speeches are likely to unnerve investors.
- From China's perspective, the fragility of the local and global economy, as well as financial and political threats from the US, means it has an interest in supporting its domestic asset markets, including real estate, equity and bond markets. For now, it appears to be favouring the stock market over others.
- We suggest investors monitor margin financing more than valuations. Domestic equities are more speculative than global peers, with investors less focused on fundamentals. The government has an eye on signs of speculative excess, such as elevated margin financing. However, it also wants to encourage more IPOs. This means it is likely to warn investors to be careful rather than crack down on margin financing at this stage. As such, we believe China markets, offshore and onshore, are likely to make new highs in the months ahead.

China market corrects 7% from July 13th peak, but remains above key support levels

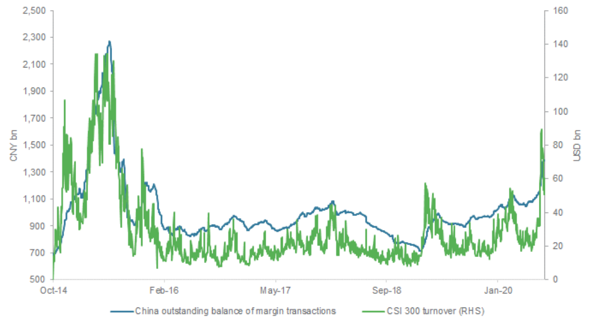
CSI300 index and technical support levels



Source: Bloomberg, Standard Chartered

China margin financing: increasing, but not excessive

China margin financing and CSI300 index



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