

Given the recent level of volatility in the Greater China equity markets, we have prepared this note to provide our view of the current market dynamics.

### What Happened in July:

The accumulated concerns over China's recent set of regulations for internet companies, together with reports on potential tightening in the After School Tutoring (AST) education sector have led to reassessments of Chinese equity market risks by global investors. The falls have been driven by reports which indicated an unexpected worse than a 'worst case scenario' – forcing academic education firms (tutoring) to be non-profits, no longer be allowed to raise capital through IPOs and limitations to foreign capital amongst potential measures, in addition to scheduling bans. Despite the official regulations remaining unpublished, as yet, these changes have caused profitability concerns for related companies and sector de-ratings. This caused a ripple effect that drove a broad market correction.

Versus the indices peak since Feb, major China indices have corrected:

| Index:           | Correction since February 2021 peak: |
|------------------|--------------------------------------|
| MSCI China Index | -30.3%                               |
| CSI 300          | -17.1%                               |
| Hang Seng Index  | -17.8%                               |

Source: Bloomberg, as at 27 July 2021

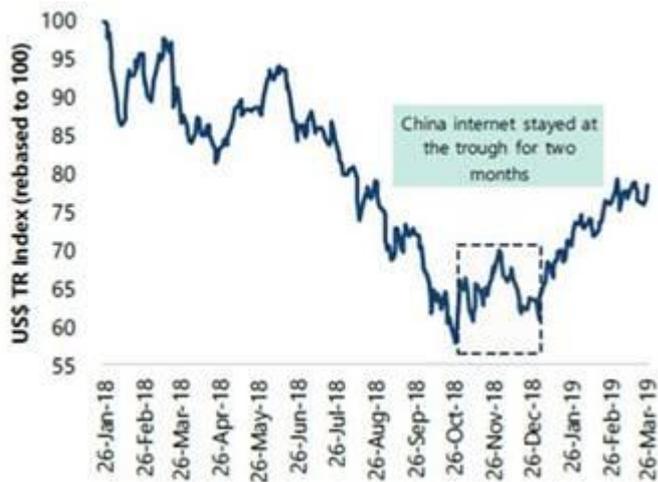
### Where the market stands vs. historical valuation levels:

Since February, the MSCI China 12m forward P/E has come down meaningfully, here is a comparison vs. market events in recent years:

| Index:  | 12-month forward P/E |
|---|----------------------|
| Current level (as of 7/27 closing)                  | 12x                  |
| 2020 COVID outbreak                                 | 11.5x                |
| 2018 Trade war + tightening measures                | 9.6x                 |
| 2015 Hard landing concerns + high debt to GDP level | 8.3x                 |
| 2008 Global financial crisis                        | 6.6x                 |

Source: Bloomberg, as at 27 July 2021

The current level suggests we are not at distressed levels and whether the selling pressure will persist would depend on the responses by central government and respective regulators. We further elaborate our views in the below section and based on similar historical incidents, policy uncertainty could take time to subside. For instance, in 2018, the China internet sector stayed at a 2-month period at trough levels when regulators implemented tightening rules on gaming:



Source: FactSet, Jefferies

### Our view and market implications

- First of all, the correction is driven by escalated regulatory activism. While regulatory tightening is not new in China, this time markets are pondering the intention as it appears to go beyond the normal frameworks (fiscal or monetary) and require reassessment.

We view that the recent policy implementations and draft consultations in various sectors **can be categorized as part of the long-term quality growth agenda – to pursue equality, balanced developments**. The Chinese Government has made its stance known and to certain extent, set the policy direction to promote “economic prosperity and social harmony”.

- That being said, near term volatility will remain as the likelihood of a complete reversal of policies is low.
- Besides the social harmony agenda, we expect that the self-sufficiency agenda would be another long term key policy focus on the back of the continued geopolitical tensions. This shall support the localisation process and a sustainable move up the manufacturing value chain.
- Despite the near term pain to curb the monopoly power of large corporates, particularly internet companies, and so improve social outcomes, **the agenda to address long term quality growth allows us to focus on identifying the potential de-rating and re-rating developments in respective sectors**.

### Portfolio positioning

- The imminent impact will be affecting internet related names and the AST in education sector. These means offshore market and ADRs are likely to face policy headwinds in the near term.
- Currently we are underweight in the internet sector level and we do not hold AST (as of 27 July) across our strategies.
- We had further trimmed internet weights across our portfolios as a result of the strong clampdown from the government and revised down their respective valuations.
- The portfolios will seek to identify longer term quality winners amid the policy headwinds, such as consumption related names, technology hardware and industrials, which still

showcase robust fundamentals.

**PAF vs MSCI AC Asia ex Japan**

|                                    | 30-JUN-2021         |                      | 27-JUL-2021         |                      |
|------------------------------------|---------------------|----------------------|---------------------|----------------------|
|                                    | Port. Ending Weight | Bench. Ending Weight | Port. Ending Weight | Bench. Ending Weight |
| Internet & Direct Marketing Retail | 2.6                 | 9.9                  | 1.6                 | 8.2                  |
| Entertainment                      | 0.9                 | 1.5                  | 0.3                 | 1.3                  |
| Interactive Media & Services       | 10.2                | 8.0                  | 5.7                 | 7.1                  |
| <b>Total</b>                       | <b>13.6</b>         | <b>19.4</b>          | <b>7.6</b>          | <b>16.6</b>          |

**PCF vs MSCI China**

|                                    | 30-JUN-2021         |                      | 27-JUL-2021         |                      |
|------------------------------------|---------------------|----------------------|---------------------|----------------------|
|                                    | Port. Ending Weight | Bench. Ending Weight | Port. Ending Weight | Bench. Ending Weight |
| Internet & Direct Marketing Retail | 8.7                 | 23.0                 | 4.9                 | 21.3                 |
| Entertainment                      | 1.5                 | 2.7                  | 0.0                 | 2.4                  |
| Interactive Media & Services       | 17.9                | 15.8                 | 12.1                | 14.8                 |
| <b>Total</b>                       | <b>28.0</b>         | <b>41.5</b>          | <b>16.9</b>         | <b>38.6</b>          |

Should you have any query, please feel free to contact us. Thank you.