



Market Outlook 2021

January 2021

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Preface:

The Year of Normalization

The year 2021 is poised for a restart. Vaccination and other signs of relief permit the world to start envisioning recovery beyond the dreadful COVID strains. A recovering process can take far more steps and we believe the five fundamental events and their developments next year outlined in Figure 1 would extend investors' risk appetite into 2021.

Figure 1: Key events constitute a more stable outlook in 2021

Key Events	2020	2021
COVID-19 Outbreak	Negative	Neutral
Vaccine Availability	Negative	Positive
Stimulus Policies	Positive	Positive
U.S. Election	Uncertain	Partially settled; Clearer after Jan 2021
Sino-U.S. Trade	Negative	Neutral

Source: Value Partners, December 2020

Vaccine: The centerpiece of the recovery

On COVID, we believe the worst is behind us as the key piece of the puzzle to recovery - vaccine development saw positive trials and approvals. The arrival of vaccines shall unlock much of the reopening and recovery process in 2021. Contrary to 2020 that growth scarcity drove skewed sectors strong performance (Figure 2a, 2b), laggards that were heavily battered by the pandemic, such as financials and retailers etc., may enter the recovery phase and bring a broader and balanced recovery in 2021.

Laggards that were heavily battered by the pandemic may enter the recovery phase, bringing a broader and balanced recovery in 2021.

While the markets have been responding positively to the vaccine scenario towards the last quarter of 2020, we believe vaccination alone cannot keep the virus at bay. Stamping out the epidemic requires precautionary measures, border control and active testing. In addition, the willingness to get vaccinated, the vaccine inventory and effectiveness would all contribute to this key piece on the recovery path.

Liquidity sets the agenda

The preemptive and supportive monetary and fiscal policies have been a major tailwind to global equity markets in 2020, and we expect the liquidity-driven environment would not subside in 2021. Firstly, the U.S. Federal Reserve has explicitly expressed its intention to keep borrowing costs low, potentially through 2023. Former Fed Chair Janet Yellen was picked to take the role of treasury secretary, which gives the market implications that a dovish tone would stay and fiscal spending may enlarge.

Figure 2a: Top performers dominated Asian equity markets performance in 2020

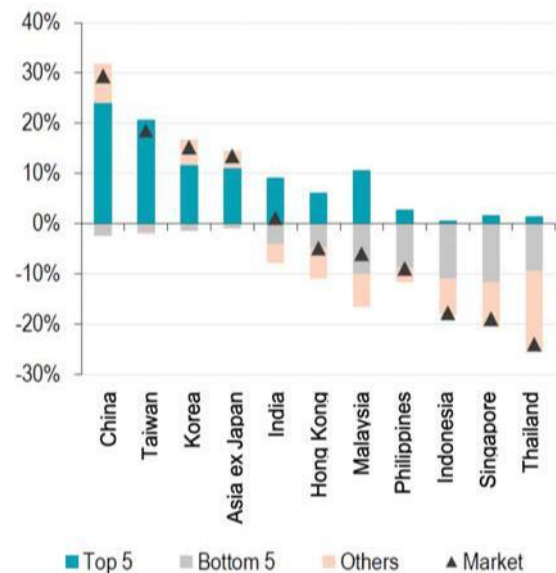
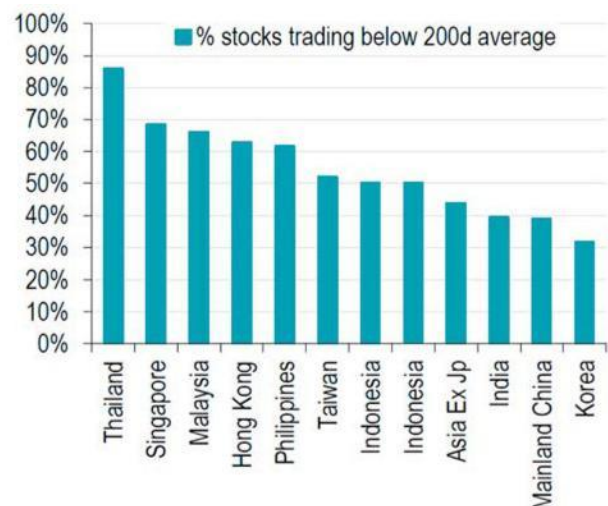


Figure 2b: High percentage of laggards across the region due to the uneven recovery paths among countries and sectors



Source: FTSE Russell, FactSet, HSBC Research, November 2020

Secondly, other advanced economies, such as Japan and Europe, are likely to follow or even ramp up their stimulus measures of other forms to guide their fragile economies away from the recession. The combination of low interest rates and abundant liquidity in the global system shall sustain investors' risk appetite in 2021, and our overweight position in equities and high-yield bonds reflects this view.

This level of liquidity has a historical track record of leading to a weakening greenback, which is positive for emerging markets equities. With the recovery ahead of the curve, China and selective Asian markets are expected to continue to attract capital inflows under the accommodative policy backdrop around the globe.

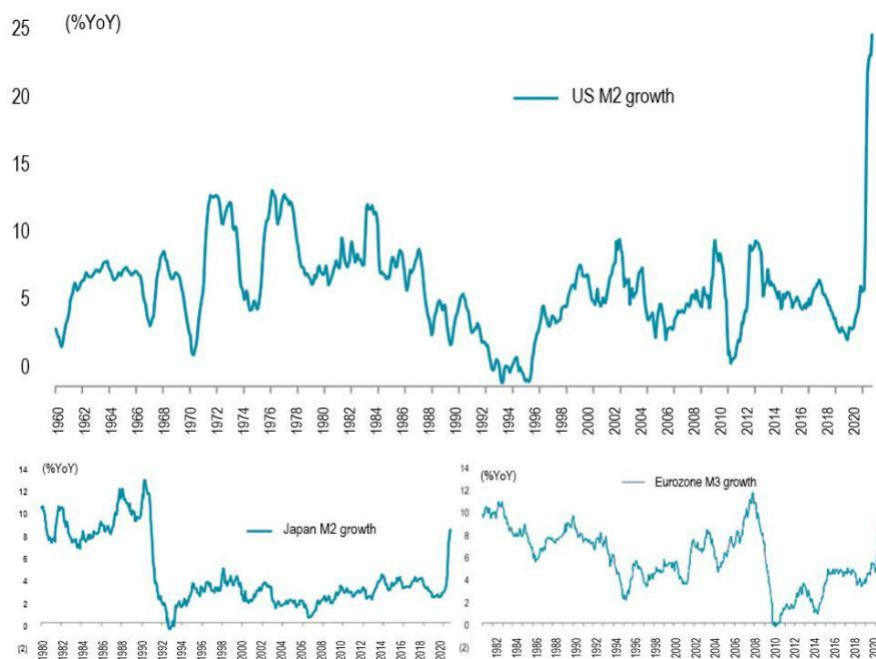
A timeout on political tussles?

The U.S. election-related risks were partially erased as Joe Biden becomes the president-elect. The attention has shifted to policy and cabinet candidate selection under a Biden administration and a Congress of a split-party control.

At this point, the Sino-U.S. relationship under the Biden administration remains uncertain, although the market generally expects a more open platform for discussion, unlike the past four years when President Trump was in office.

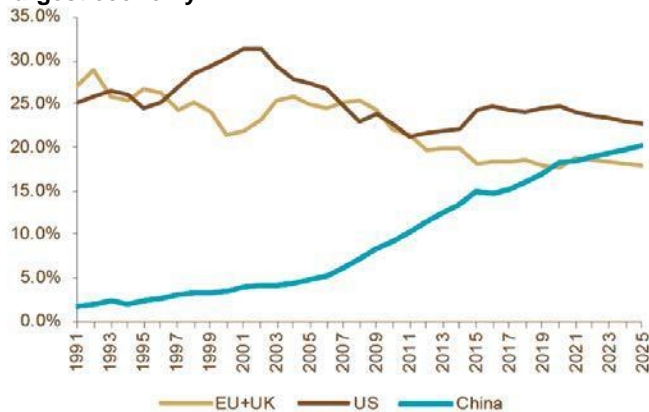
The intensity of tension is not expected to go away entirely and we do not foresee a complete reversal of the policies implemented during Trump's presidency.

Figure 3: Liquidity remains abundant



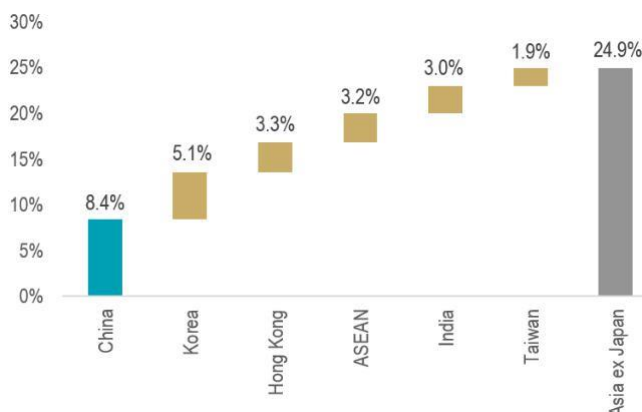
Source: Federal Reserve; European Central Bank; Bloomberg, Bank of Japan; HM Treasury, Bank of England, Jefferies

Figure 4a: China's economic power, in the share of GDP terms, surpassed the European Union and the UK combined, soon becoming at par with the U.S., the largest economy



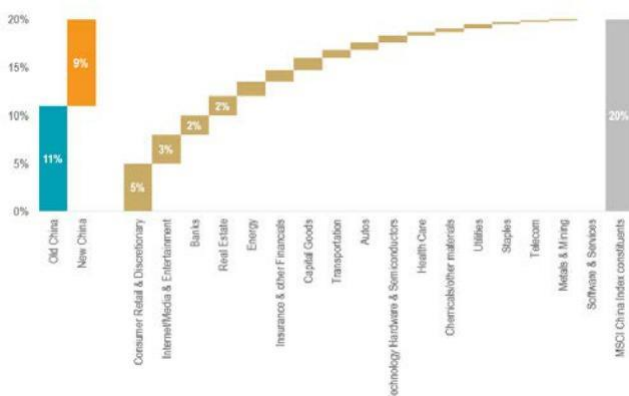
Source: International Monetary Fund, Comtrade; Macquarie Research, December 2020

Figure 5a: China remains the engine to drive regional earnings growth, expected to take up roughly one-third of growth contributed to Asia ex-Japan equities in 2021



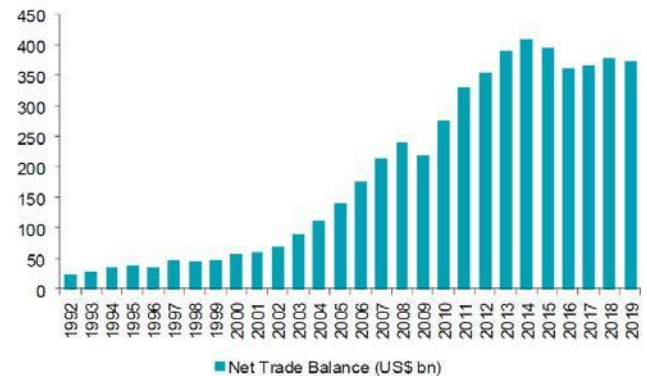
Source: FactSet, MSCI, Goldman Sachs Global Investment Research, November 2020

Figure 5b: EPS growth of MSCI China Index constituents would be on an even keel between old and new economies



Source: FTSE Russell, FactSet, HSBC Research, November 2020

Figure 4b: China's consistent surpluses of net trade balance (USD bn)



The regional earnings-per-share growth is expected to rebound by 25% in 2021, with China contributing one third of the growth.

Unlike in the past decades, when China was the world factory to supply labor at low cost, the U.S. and its Western allies have repositioned their tactics toward China, to some extent driven by China's rise and ability to exert greater influence on the global political and economic arena (Figure 4a & 4b) as well as its rapid development in the higher-end value chain categories, such as technology. Several reports released by the U.S. use the rhetoric that take China as a strategic competitor. Thus, sanctions and restrictions could become an ongoing topic, especially if protectionism remains a key policy agenda.

China's Five Year Plan, a blueprint to steer the country's economic development, announced that the dual circulation strategy is at the core of this plan and a response squarely addressing the changes in geopolitical dynamics. The circulation's internal loop emphasizes the importance of local demand and moving up the industrial chain to engage in advanced manufacturing. Given that geopolitical risks may be ongoing, China taking a domestic-oriented approach as a pillar strategy shall reduce the growth volatility driven by external risks. (See our sector pick in *China equities: Domestic demand and dependency.*)



Asset allocation views

Vaccines, coupled with continuing support from central banks, shall lend support to extend the momentum of investors' risk appetite in 2021. Our cautiously optimistic views are reflected in the overweight position in equities and high yield bonds (Figure 6). Furthermore, the softening U.S. dollar is anticipated favoring emerging market equities if history is any guide.

Asia ex Japan equities, especially China-related companies, continue to be in focus. As indicated in Figure 5a, the regional earnings-per-share growth is expected to rebound by 25% in 2021, with China contributing one-third of the growth. Unlike the past couple of years, profit growth derived from old and new economy sectors is forecasted to be more balanced (Figure 5b). Besides, South Asia equities, a major regional laggard in 2020, is highly sensitive in nature to foreign fund flows and may see selective value opportunities.

On the fixed income side, the rosy earnings estimate and the sentiment towards Asian corporates will continue to lend support to high yield bonds. An eased risk aversion globally, together with a low-rate environment, would benefit the Asian high yield issuers.

Other than the stock and bond rally in 2020, Gold was one of the winning asset classes as bullion reset the historical high of over US\$2,000 per ounce. Demand for gold would continue as a portfolio diversifier, although gold prices may be range-bound into 2021 as extreme risk aversion may subside under a broad recovery.

Figure 6: Asset Allocation Views for the next 12 months

Equities		Bonds		Alternatives	
U.S.	→	U.S. treasury	↓	Real Estate	→
Europe	→	Other developed markets treasury	↓	Precious Metal	→
Japan	↑	U.S./European investment grade	↓	Cyclical Commodities	↑
North Asia (ex-Japan)	↑	Asian investment grade	→	Gold	→
South Asia	↑	U.S./European high yield	→	Cash	↓
Other emerging markets	↑	Asian high yield	↑		
		Emerging markets bond	↑		
<div>  Add exposure  Remain the same  Reduce exposure </div>					

Source: Value Partners, December 2020

China Equities: Domestic Demand and Dependency In Focus

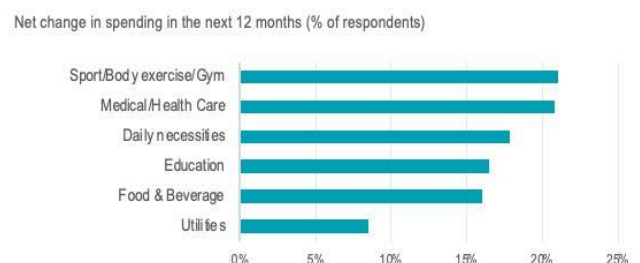
1. Consumption upgrade

The pandemic impacts did not interrupt the structural trends of consumption upgrade in China (Figure 7) as the willingness to spend more on lifestyle upgrades continue. The drivers of growth – the rise of the middle class, surging household income and urbanization – remain intact and continue to spur on domestic consumption in the future.

Our focus has been leaders with scalable businesses operating under reputable and innovative consumer brands in China, which best position them to capitalize on structural trends.

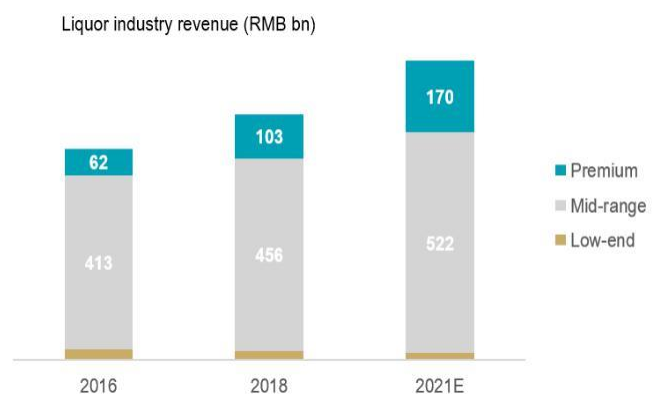
While the Chinese individual savings level is among the highest globally, consumption only accounts for a smaller proportion of China's GDP than that of Japan and the U.S. This situation continues to evolve, however, especially when domestic dependency is a core policy agenda to steer China's economic development. Such an agenda is well supported by the rising purchasing power of middle-class income nationals. This cohort accounts for 600 million citizens¹ – roughly a double of the U.S. population – and serves as a solid ground to foster the consumption upgrade behavior.

Figure 7: Consumers shift to spending more on consumer items related to personal well-being



Source: UBS, November 2020. Measured as % of people who will spend more minus % of people who will spend less.

Figure 8: Premium baijiu is expected to see the highest demand growth among liquor products in China (RMB bn)



Source: Euromonitor, company data, Morgan Stanley Research, July 2020.

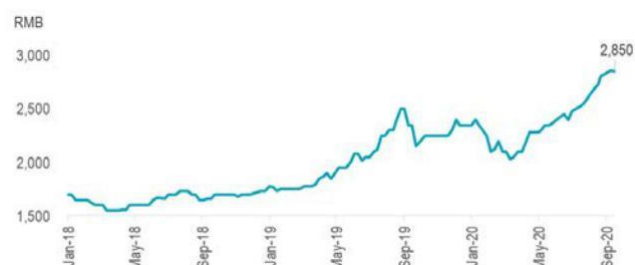
¹ Source: Citi estimates

Within China's expanding consumer market, our focus has been the leaders with scalable businesses operating under reputable and innovative brands, which best position them to capitalize on structural trends. Using this logic, we illustrate the power of premiumization on the mainland with Chinese white liquor (baijiu) as an example.

High-end baijiu makers' value is predicated on the perceived social value and the limited brewing capacity (Figure 8). In the premium liquor industry, new brand entrance is unlikely as it has been highly consolidated and dominated by four known brands. Due to their strong market positioning, sustained demand from affluent consumers and increasingly from the mass market, top-tier baijiu's pricing power was up strongly even under COVID-19 interruptions (Figure 9, 10). This confirms our thesis of sticking with quality leaders.

Another example is sportswear. The COVID-19 outbreak exposes the critical importance of an individual's well-being and enhances public health awareness. This brought exercise to the forefront and gave a boost to the Chinese sportswear market, providing that sportswear as the category mainland shoppers would spend more on (Figure 7). From top-down, increasing the population who exercises regularly is also on the central government's agenda as it plans to bring the current 34% actively exercising population to over 40% in 2030². These are beneficial to sportswear makers,

Figure 9: The wholesale price of 53% Feitian Moutai (per bottle)



Source: Kweichow Moutai, Value Partners, September 2020

Figure 10: Sales of top four baijiu brands outperformed the broader market despite COVID-19



Source: National Bureau of Statistics, Company data, Wind

² Source: The State Council of the People's Republic of China, July 2019

which are expected to grow at a compound annual growth rate (CAGR) of 13%³.

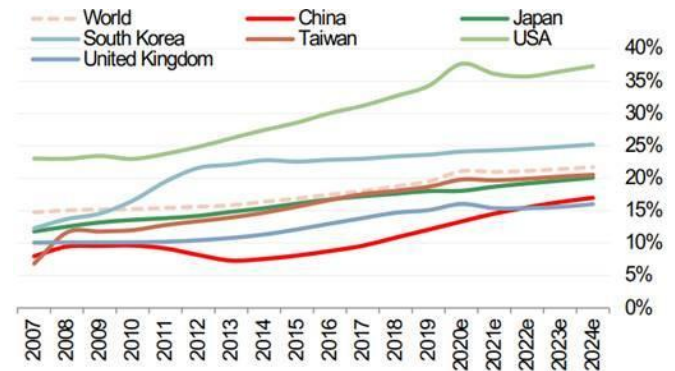
Apparel is always associated with sentimentality; with sportswear not an exception. Guochao, which literally means China's chic, expresses confidence in national identity and appreciation of traditional culture in outfits. Riding on the homegrown fashion wave, the sentimental makeover helps premiumize the brand image of quality domestic sportswear names, which take up popularity among the younger generation in particular. It collides with the trend of athleisure style, which blends active and fashionable wearables.

It would catalyze a convergence of Chinese activewear spending towards its neighboring countries (Figure 11), driving the per-capita expenditure of US\$33 closer to the average of US\$145 among other Asian countries. Other than sentimentality, another important catalyst to drive sportswear to premiumize is the advancement of materials and functionality, that arouses shoppers to pay a premium for a better experience.

2. E-commerce platforms

E-commerce platforms have been in the spotlight through the pandemic, especially during the citywide lockdowns. We consider the pandemic as one of the major tipping points for e-commerce adoption as the lockdown boosted the usage and first-time user experience when people needed to shift consumption from offline to online. We believe the convenience brought by digitalization is an irreversible trend to drive e-commerce growth structurally.

Figure 11: Sportswear takes roughly 15% of China's total apparel market.



Source: Euromonitor, Morgan Stanley Research, November 2020

Increasing the population who exercises regularly is on the central government's agenda as it plans to bring the actively exercising population to over 40% in 2030¹

³ Source: Euromonitor, Morgan Stanley Research

After the year-to-date rally on share prices, our approach to e-commerce has strategized towards more on services-oriented e-commerce platforms. Mainland Chinese shoppers spend less on service-related items than the neighboring and advanced economies (Figure 12). Even more, the penetration rate of e-commerce platforms offering services is a mere 10%⁴, far less than the platforms for merchandized goods that penetrates 30% of the market. The untapped market, expanding online spending habits and gradual upgrade in consumption would altogether uplift these platforms' user base and eventually their profitability.

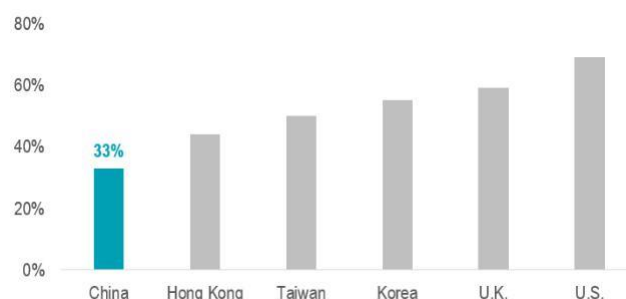
Investment case:

We take an online fresh food marketplace as an example. We favor the leader in the field as they innovate and have overcome a major logistics challenge leaping ahead of its peers.

Some e-commerce platforms are impeded by the limited shelf life and the time-constrained delivery of fresh produce across the mainland. The company launched an eco-system that collaborates with widely found mom-and-pop stores for last-mile delivery. Customers can pick up packages from local shops while the platforms enjoy substantial cost benefits. The centralized stocking and refilling also enhances efficiency. This is a breakthrough that enables an increasing user base and profitability, thus forming a solid investment case (Figure 13).

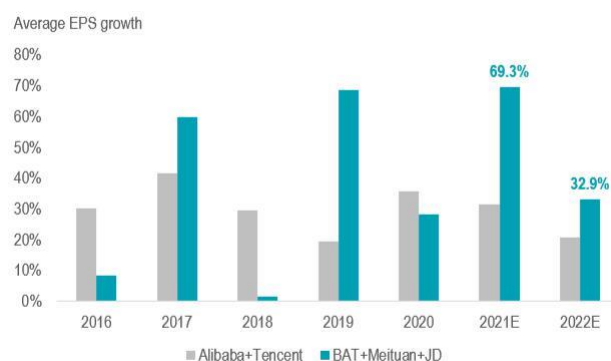
We consider the pandemic as one of the major tipping points for e-commerce adoption as the lockdown boosted the usage and first-time user experience when people needed to shift consumption to online.

Figure 12: Service consumption in China accounts only for 33% consumer spending, lagging far behind advanced economies



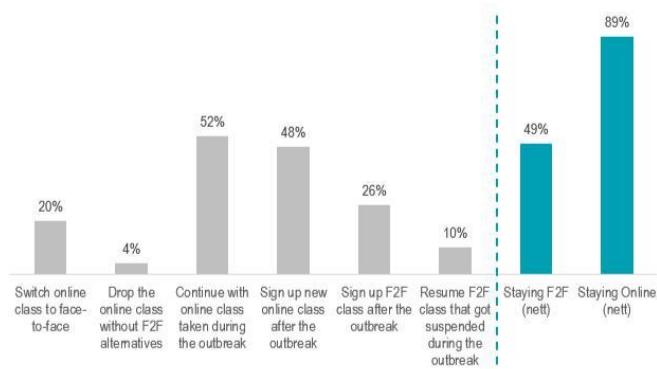
Source: WIND, UK Office for National Statistics, Statistics Korea, National Statistics of Taiwan, Census and Statistics of Hong Kong SAR, National Bureau of Statistics of China

Figure 13: Service e-commerce platforms add more fuel to earnings growth among the key tech giants in China



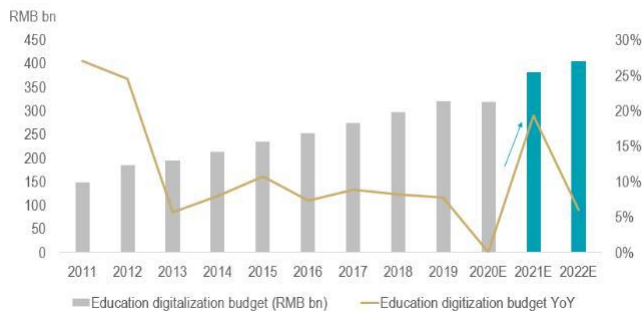
Source: Value Partners forecast, HSBC research

Figure 14: A majority of parents continued to sign up for online courses post-COVID



Source: Morgan Stanley Research. Note: Do not sum to 100% as multiple answers are allowed.

Figure 15: The Chinese government commits abundant resources to digitalize the education system, which brighten the outlook of online tutoring operators



Source: Morgan Stanley Research

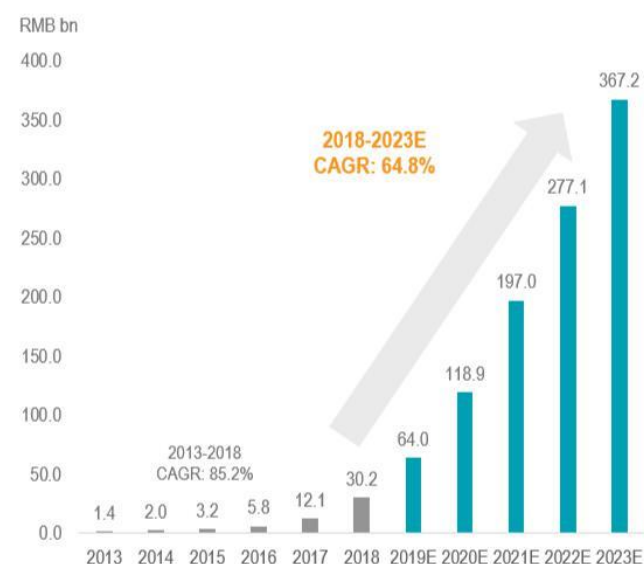
3. Education – From online to tertiary schools

China's system of kindergarten to 12th grade (K-12) education faces a slew of factors that would enable the industry to thrive. First, the willingness to sign up for online courses among students has not dimmed (Figure 14) despite a partial reopening of offline teaching. Next, the online operators are supported by accelerated digitalization triggered by the pandemic norms. The environment remains favorable as the official budget to bring teaching and learning online is expected to touch RMB400 billion by 2022 (Figure 15), about 25% increase from 2019.

Lastly, China's 14th Five-Year Plan also looks set to harmonize teaching quality and delivers comparable learning outcomes between urban and rural communities via online education. Furthermore, the general rate of attending K-12 after-school tutoring stands below the 30% mark⁵, while the penetration of the online tutoring industry is less than 20%, implying an ample room for development. The low penetration would buoy the users on the tutoring platforms (Figure 16).



Figure 16: China's online K-12 after school tutoring market looks set to enjoy an exponential growth rate in gross billing terms



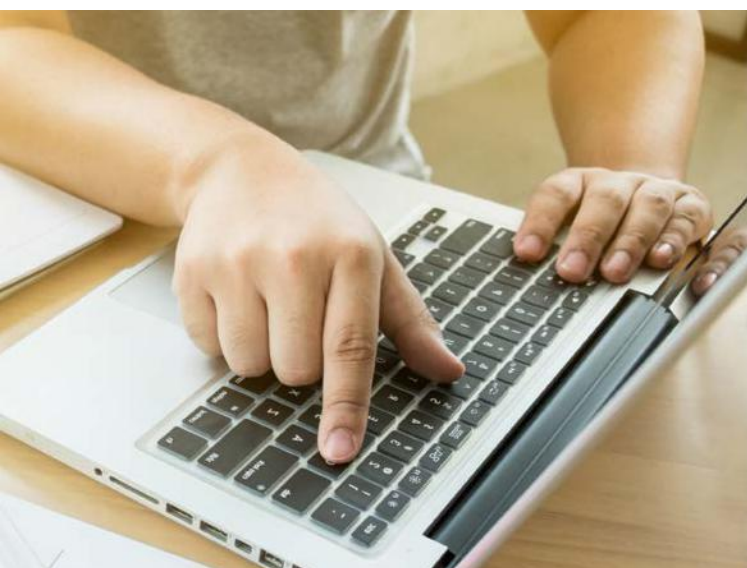
Source: Frost & Sullivan, Macquarie Research, November 2020

In our stock-picking, we prefer the front-runners with extensive pedagogic research, advanced application of artificial intelligence technology and effective tutor management. These established competitive advantages are likely to keep a considerable distance between leaders and laggards.

In the other corner of the market, our observation on imbalanced demand and supply of tertiary education remains unchanged. China's central government has a long-term agenda to ramp up self-sufficiency and move up the value chain. This ambition implies a growing crave for educated and skilled workers, pointing to robust demand for an advanced and sound tertiary and vocational education system.

In 2019, some 9.5 million candidates⁶ sit for the National College Entrance Examination, the Gaokao, but only 7.5 million of them find places in tertiary education, creating a supply gap for the remaining two million without places. Penetration of higher education in China is still at an early stage but set to grow markedly. China's gross university enrolment rate is currently at 52%⁷, compared to 93% in the U.S. The Chinese government has set a target to lift the rate to 65% by 2035.

Currently, the market of mainland education players remains highly fragmented, indicating the availability of merger and acquisition opportunities. Smaller private universities and colleges in China might well be prepared to share their ownership stakes with more scalable players to benefit from economies of scale. Considering all these factors, we believe Chinese higher education has significant potential to be a source of solid income growth in the future.



⁶ Source: CSCI Research, Frost and Sullivan, Morgan Stanley

⁷ Source: Ministry of education, July 2018. China State Council Information Office, May 2020



4. Advanced technological hardware

As mentioned in the *Preface*, China's dual circulation emphasizes internal circulation with a focus on increasing self-sufficiency and industrial upgrade. Domestically, technological hardware continues to be at the heart of China's economic development. We believe the sustained commitment in developing maiden technology inventions would be necessary to build the self-dependent economic model.

The sector relating to the Internet of Things (IoT) has broken ground not long ago and investment demand for a new cohort of related infrastructure looks set to increase (Figure 17).

In our view, the IoT driven era would open growth avenues, meaning sustainable earnings headroom for respective value chains. For instance, IoT comprises of individuals, corporate and industrial applications. Compatible software, accessories and systems are necessary to enable the gadgets, also leading to value-added content such as new forms of entertainment, consumption, transportation, smart city infrastructure and finance. The application of IoT devices also unlocks a new era of manufacturing, such as industrial-use automation, which allows a wider range of customization and smarter production processes.

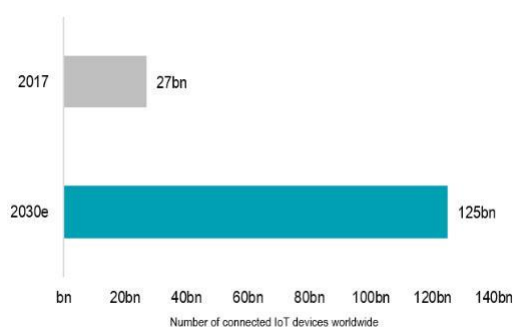
In addition to the increasing adoption of IoT applications, policy is the clincher. The general direction of China's FYP has provided critical information on domestic industrial and innovation upgrades – the officials will have to commit substantial monetary and non-monetary support to help lift

low self-reliance (Figure 18) and drive increasing capital expenditure in various new infrastructure (Figure 19).

China's internal circulation has a focus on self-sufficiency and industrial upgrade. We believe the sustained commitment in developing maiden technology inventions would be necessary to build a self-dependent economic model.

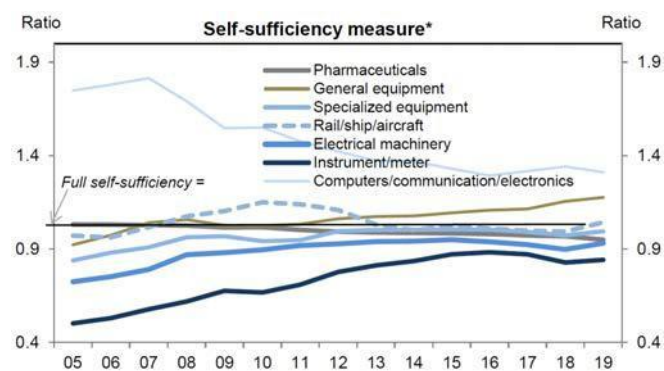


Figure 17: Internet of Things devices will see an exponential growth by 2030



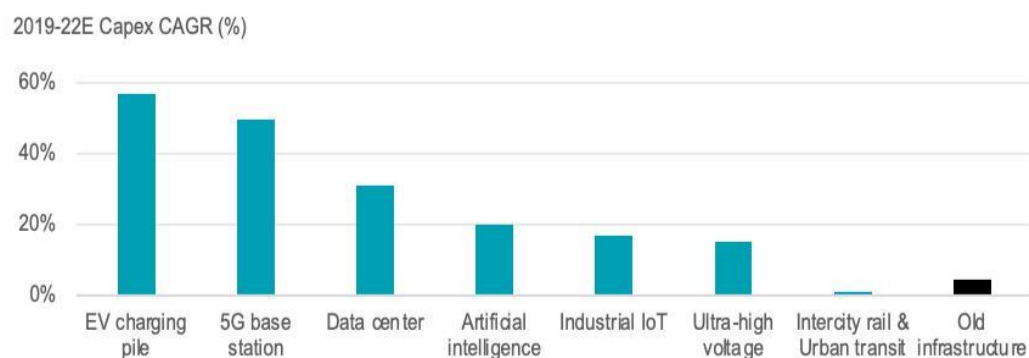
Source: IHS Markit

Figure 18: China's self-sufficiency rate has room to catch up, in particular in the advanced tech areas



Source: WIND, Goldman Sachs Global Investment Research, November 2020. *Ratio of domestic production to domestic demand

Figure 19: China is on the way to an era of building new infrastructure, wherein growth is far more exciting than old infrastructure



Source: WIND, Goldman Sachs Global Investment Research, November 2020

5. Healthcare – Unshaken long-term demand

The ongoing shifts in China healthcare sector, such as demographics transition, regulatory revamp and sector consolidation, remain relevant.

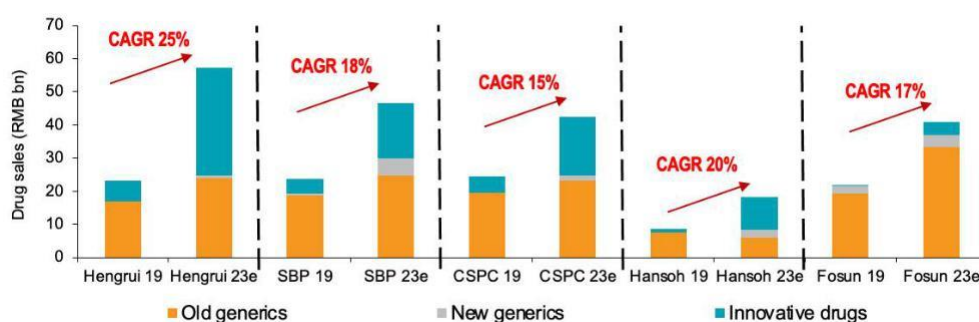
Firstly, China's over-65 population is projected to reach 310 million by 2050 and account for 23% of the population⁸. By then, China's enormous elderly population is estimated to exceed those of the U.S., Japan and Europe combined. The aging population's incremental demand would need a robust healthcare system and improved access to affordable yet quality drugs. Despite the growing need, Chinese nationals' medical expenditure is still far behind other advanced economies, totaling a mere 6.4% of GDP⁹. This is compared to 17% in the U.S. and 12% in Japan and Germany.

Second, to command a better public health system, Chinese authorities have renewed some regulations that have triggered sector consolidation. For example, several rounds of bulk purchases under the Group Purchase Organization (GPO) scheme were implemented. In hindsight, despite the price cut, high-quality domestic players have continued to gain market share as a result of winning GPO bids.

Other than quality enhancement, innovation is a key to unlock the golden door to the true potential of China's healthcare companies. This is in line with our preference of pharma companies in China – possessing strong innovation capability and rich pipelines, which shall make them fare better against the GPO. In this space, we continue to favor the leading players that can maintain a visible cycle for drug and innovation discovery. As indicated in Figure 20, five leading pharma names on the mainland see a compound annual growth rate (CAGR) in the double-digits in the next couple of years, mostly driven by innovative drugs. This confirms our unshaken view toward the sectors' frontrunners.

The aging population's incremental demand would need a robust healthcare system and improved access to affordable and quality drugs.

Figure 20: Innovative drugs are the common driver of the leading pharma companies, enabling double digit CAGR in the forthcoming years.



Sources: National Medical Products Administration, Yaozhi, Company data, HSBC Qianhai Securities, June 2020

The case is further fostered by the Five Year Plan, which sets to encourage maiden research and development of innovative drugs to be sold and used domestically. By 2025, it is estimated that the market share of the top four domestic drug makers would reach 30% from the current single-digit level¹⁰.

⁸ Source: Population Pyramid, Statistics bureaux of respective countries as of October 2019

⁹ Source: IBID

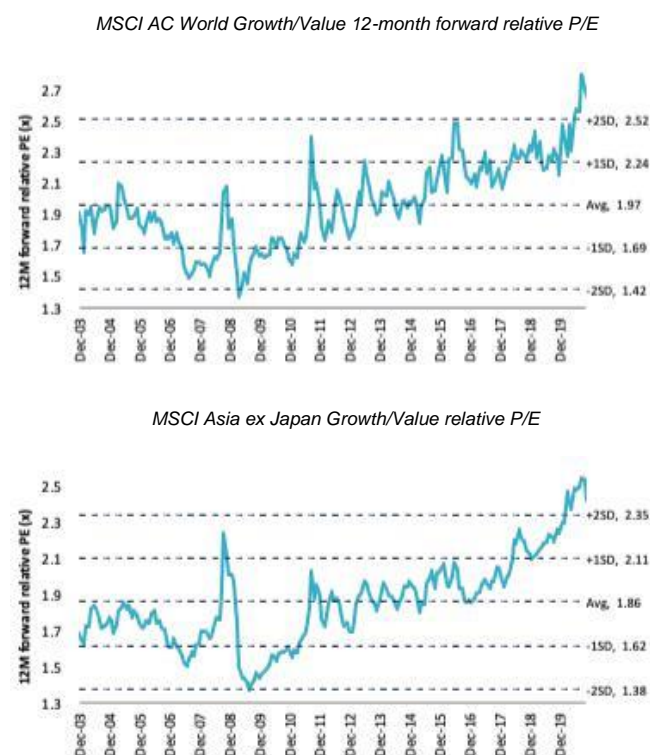
¹⁰ Source: IQVIA, Company data, CITI Research, 2019

6. The market's unloved corner

Some sectors had been punished during the pandemic outbreak, which they lagged and now appear attractive from a valuation perspective. The tables have turned recently as vaccine breakthroughs, central bank liquidity and a stabilizing economy together fuel a switch into these beaten-down stocks. We look through the catalysts for this reversal and exhibit the cases in the context of mainland Chinese companies.

The valuation gap between value and growth stocks is extreme (Figure 21) as such gap in both the MSCI World Index and the MSCI Asia ex Japan index stands at more than two standard deviations above the long-term average. As aforementioned, the normalization shall drive a more balanced return profile for equities in 2021, and we expect the value rotation to happen in selective sectors that benefit from the broader macro recovery, such as Chinese financials,

Figure 21: Extreme gap between growth and value stocks is expected to reverse and narrow



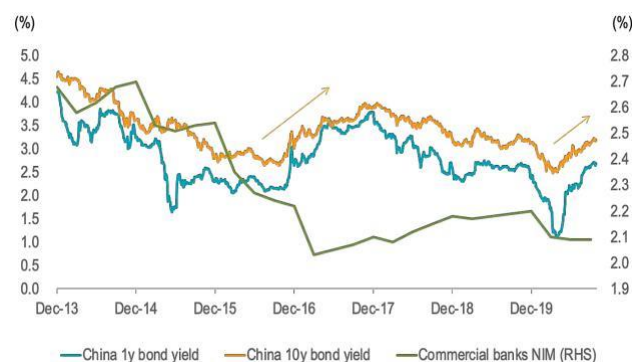
Source: Jefferies, FactSet, November 2020

which have been trading at close to historical trough valuation levels. A couple of improving factors could drive a more positive outlook for the bank sector in 2021. Firstly, banks, as the macro proxy, tend to perform well in a strengthening macro environment. The vaccine would arguably solidify the control of the pandemic spread, supporting the macroeconomic recovery trajectory. This shall help ease concerns on non-performing loans and drive improving end demand on loan facilities. Secondly, the 10-year bond yield is believed to remain above the 3% level, which is historically positive on banks' net interest margin and drives a brighter profitability outlook (Figure 22).

Similarly, insurers receive tailwinds as the economy improves and the bond yield trends up. Resumption of offline agency network, rising bond yields and the anticipated positive A-shares market performance would form a re-rating case for the insurance sector.

We expect the value rotation to happen in select sectors that benefit from the broader macro recovery, such as Chinese financials

Figure 22: China's 10-year bond yield is forecasted to be 3% through 2022, a considerable margin above that of the U.S.



Source: CICC Research, November 2020



Conclusion

To sum up, the ample liquidity in the system is unchanged under the continued support from global central banks, while vaccinations would enable wider economic reopening, harmonizing the uneven recovery path we have seen through 2020. More balanced market returns are expected in 2021. In China equities, we believe some structural trends that we identified before the COVID-19 hit continue to shape the economic transitioning and uncover the winners of the future. Thus, our convictions toward mainland Chinese companies remain intact and we foresee that China's effective handling of the pandemic, pivotal sector pillars and solid directions of economic development will play out and support a bright outlook for 2021.

Asian Credits: Income Theme Takes Centre Stage

With the vaccine's arrival, we believe the uneven recovery of economies and Asia's credit markets would smoothen. In 2021, the market's focus will likely turn away from rates, which had a stellar performance through 2020, to credit markets, where one needs to find spread compression opportunities for the next year. The basis of this thesis is that the spectrum of the macroeconomic recovery is to broaden widely to some laggards and the liquidity support in the global markets is yet to taper.

Firstly, we believe the U.S.'s overall monetary and fiscal policy will steer a dovish path for the forthcoming years. This is primarily linked to the fact that former Federal Reserve chair Janet Yellen was chosen to serve as Treasury Secretary, a pivotal role directing economic policies. This anticipated appointment adds a dovish overtone to the existing and extensive easing program in the U.S. system. This is in addition to the messages from the Fed to maintain borrowing rates fairly low. All in all, the policy backdrop would match the efforts in restarting the frail U.S. economy weakened by the pandemic recession.

In the bond market, such an ample level of liquidity continues to search for income. But the essential question is – where do we still see opportunities when the yield offered by quality treasury bonds touches new lows?

In the aftermath of the indiscriminate selloff in March 2020, the higher-rated issues emerged from the dip stronger than the broad market, as the motives for searching for strong and quality assets among global investors strengthened, factoring in the uncertain COVID outlook. Subsequently, the

divergence in spread between investment grade and high yield issues was pulled wider to a level only reached more than 10 years ago. Thus, the disproportionate credit market recovery points to room for further spread compression into 2021.

Also, the critical advance in vaccines would smoothen the uneven recovery paths post-pandemic. Such dislocated asset prices, coupled with the unchanged liquidity supply from central banks, would imply investment opportunities in Asian high yield issuers. Credit selection remains pivotal.

In our view, Asian markets, especially China, are the first batch to walk out of the recession fears with an effective handling of the virus. The market now estimates a 25% of earnings growth for the whole region through 2021, supporting the overall outlook of Asian corporate and high yield issues. Moreover, China's 10-year bond yield also maintains and will keep a considerable margin above the comparable metrics of the U.S. This is evidence of the relative value of China versus the U.S. expectations and how the U.S.-China conflict will play out under a Democratic White House.

In terms of sector, China property issuers is still our preference. The asset-heavy model provides higher transparency for bondholders with regards to their financial health. We can assess the land bank and home inventory and verify their balance sheet health.

Moreover, this space is highly scrutinized and over the past months, the authorities gradually shifted to a more hawkish stance. The meeting reiterated two messages relating to the property market: 1) ensuring a stable and healthy development of the property market; 2) “houses are built to be inhabited, not for speculation”. The introduction of “three red lines” rules followed to regulate financing activities.

The “three red lines” are: 1) debt-to-asset ratio more than 70%, 2) net gearing more than 100%, 3) cash to short-term debt less than 1.0 times. Developers will be categorized as one of four camps with color code – red, orange, yellow, and green – to control the growth of their total debt scale from 0%, 5%, 10% and 15%, respectively. We see the sector’s divergence also intensifying with the increasing margin pressure due to high land costs under consistent price caps. However, we suggest that the financing rules will target more on new loans than the existing ones, minimizing the risk of an excessive tightening given the need for a stable economy and financial system.

With such rules, home prices are to stabilize and their bond performances supported. We continue to stick with quality names with better management on their debt portfolio and larger land banks, which altogether offers a safety margin.

Uncertainties to watch out for

First, the market currently prices in the expectation of a mass vaccination to occur with high efficiency that would lead to a broad recovery. Given the considerable challenges in vaccine production and inventory, the credit market may oscillate following the vaccine news.

Another risk is that, for now the U.S. is a wild card – whether Joe Biden as the new president could live up to



Mounting risks and minimizing policy room in the U.S. support a theory of sticking to where we find relative value. China’s high yield offers an average of 8% in yield, versus 4% from the U.S. and 1% from Japan issues.

The credit market may oscillate following the vaccine news. Another risk is the U.S. which is still a wild card.

Constructing a portfolio of strong income generation, manageable volatility and capital appreciation is achievable. We go down the credit curve in intermediate-duration investment grade bonds. On the high yield side, we stay relatively closer to home, investing in some benchmark names rated at B or BB as well as selectively adding bonds of a B- rating.

A benign outlook is a prerequisite for yield compression to occur among the laggards of 2020. While being wary of the potential risks and their impact on credit performances, we are generally optimistic about Asian issuers, in particular those that have good credit metrics and heavy in assets. In the foreseeable future, we continue to prefer a strategy that focuses on strong income generation and liquidity management.

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