

16 March 2020

China Market Strategy

Fighting COVID-19, Chinese Style

**This report was written on 2020.03.15, before the news of the Fed's unprecedented monetary move.*

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"It was the spring of hope, it was the winter of despair." – Charles Dickens, A Tale of Two Cities

And it is a time for epic market moves. After last week's historic volatility in the US market that was not supposed to occur during earth's lifetime, the S&P 500 closed **RIGHT** at its 850-day moving average (at 2,711 vs. 2,705; **Chart 1**).

We have discussed repeatedly regarding the significance of this long-term moving average, as it is in rhythm with the length of a short economic cycle of 3.5 years x 12 months x 20.2 days = 850 days ("A Definitive Guide to Forecasting China Market", 2019.09.19). In the past, not even the "Black Monday" in 1987 could penetrate this moving average. ***If the index trades consistently below the 850-day moving average in the coming weeks, the odds of a global recession, which has already surged, will be impossible to ignore.***

Many tried to explain Friday's epic reversal from the brink by the coordination of global central banks' emergency monetary easing moves. But we all understand that monetary and fiscal stimulus can do little to fight the coronavirus. In the near term, to contain the virus's contagious spread, countries must lock down their cities; they must provide emergency loans and other reliefs for small businesses to ease their working capital constraints; aggressive and free virus testing must also be available to quickly locate the potential spots of contagion. Besides that, as time passes, we pray.

These are the steps that China has taken to fight COVID-19. Countries are now taking the pages from China's playbook: Spain and Italy have locked down the entire country; a number of US cities have declared emergency state. Trump's speech on Friday let the market see a definite path to combat the coronavirus. Despite continuing uncertainty and challenges ahead, the market swung from despair to hope. Based on China's experience, such hope alone will help stabilize the market, as China did after the historic plunge on the first trading day after the Lunar New Year. ***Next, the global markets will likely continue to heal, despite rising new confirmed cases*** – till the new confirmed cases start to decline for some time, validating the inflection of the virus spread. Then, the market will return to the reality of weakening fundamentals.

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Our technical and sentiment indicators confirm such forecasts based on the Chinese experience from a different angle. Note that Hong Kong is extremely oversold, as indicated by the percentage of index members making new 52-week lows (**Chart 2**). The sentiment in Hong Kong is also extremely depressed, as observed on an intra-day basis on Friday, 13 March (**Chart 3**). ***Historically, when the market was oversold at such extreme levels, and sentiment was so extremely depressed, a technical rebound started to unfold in the ensuing weeks.***

But we continue to have reservations about China's role as a "risk haven" during the global storm. Our analysis shows that the northbound net fund outflow via the stock connect is at record levels. The northbound funds tend to be smart money, as evidenced by their escape in April 2015 – right before the bubble burst in June 2015, and again in February 2018 when one of the steepest market corrections in China's stock market history began (**Chart 4**). Further, the A50 index futures has run into resistance, and has been range-bound since June 2015 (**Chart 5**).

In sum, governments around the world have come to terms with the harsh reality of COVID-19, and have followed China's suit to fight the virus spread. The more effective the quarantine efforts are, the more costly it will be economically. China has started to go back to work cautiously. But capacity utilization is only half of or even less than half of the usual levels, as indicated by property sales, traffic, electricity generation and land supply data, etc (**Chart 6-15**). ***In the near term, governments' resolve and monetary easing in an extremely panic market will induce technical rebound, although the market will probably retest its prior low. But precisely because the market can gain from draconian quarantine measures in the near term, the longer-term economic outlook is turning increasingly clouded.***

Focus Charts

Figure 1: The historic plunge now vs. 1987: S&P 500 back RIGHT at 850-day mavg

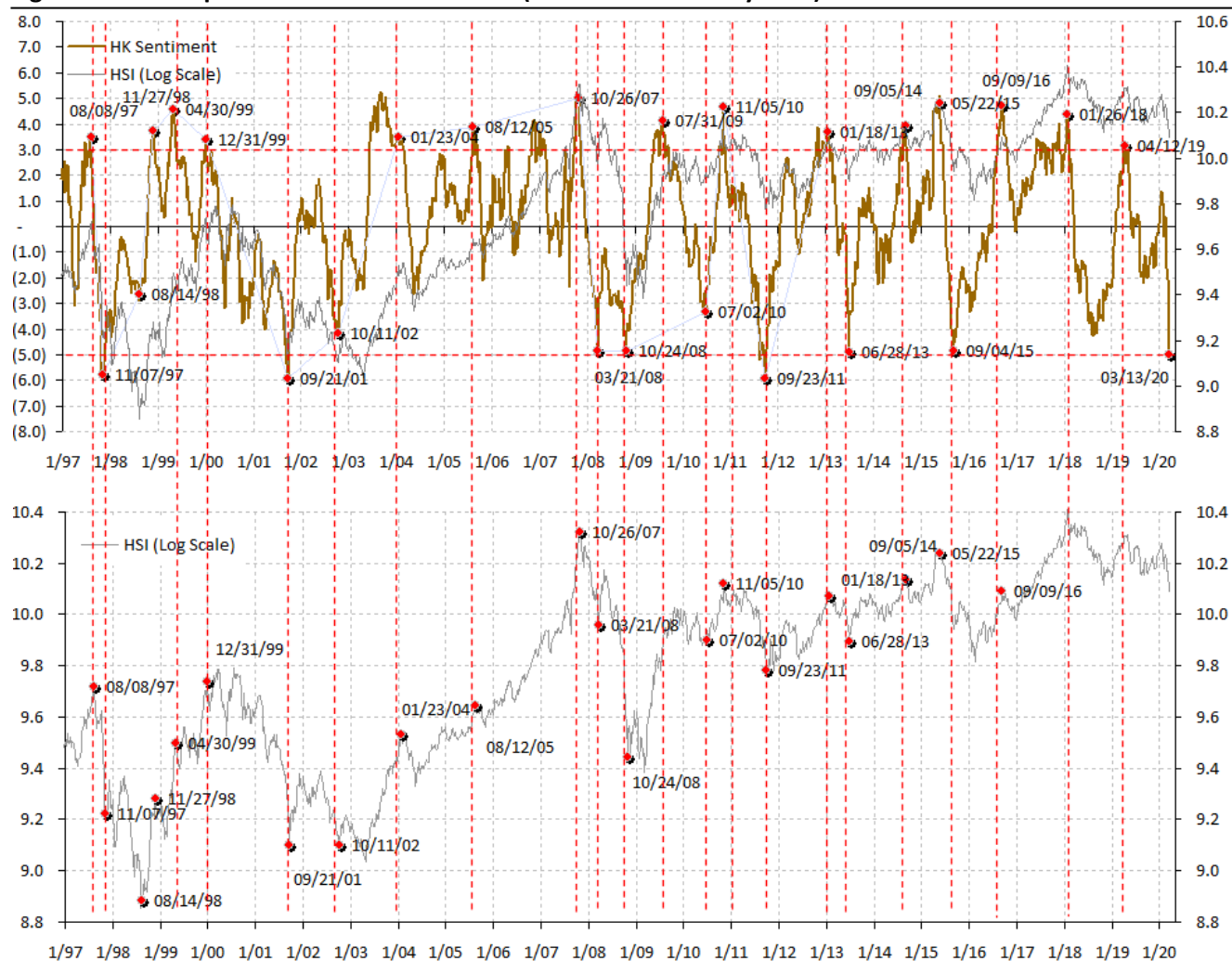


Source: Bloomberg, BOCOM Int'l estimates

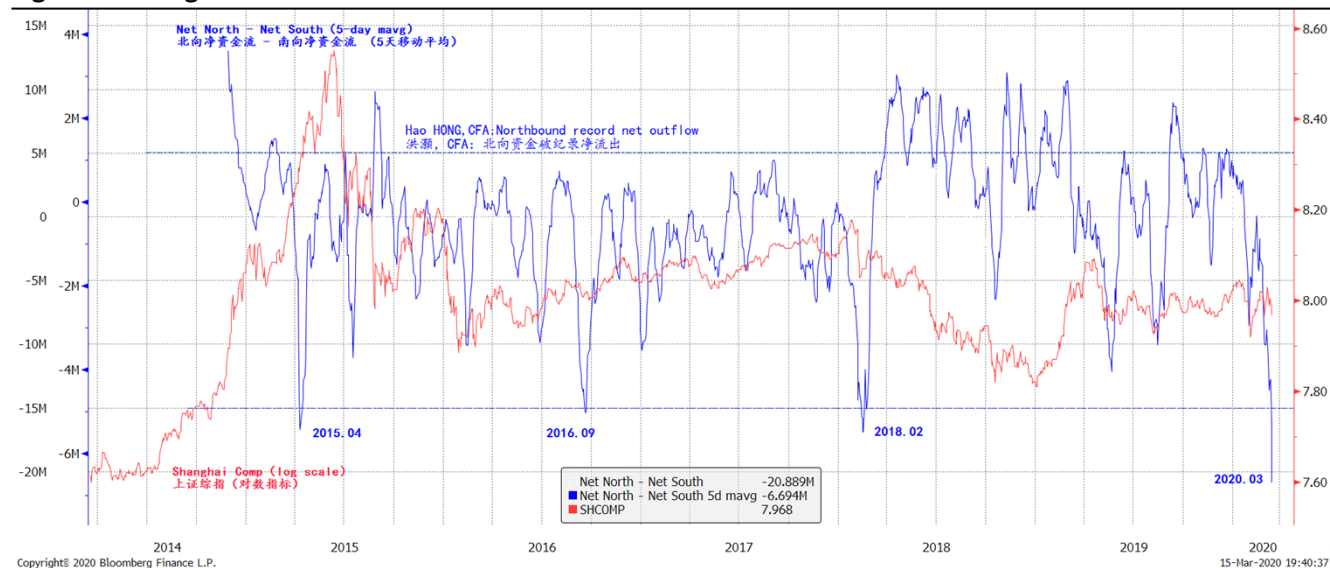
Figure 2: Market oversold at its extreme, second only to 2008 and 2011



Source: Bloomberg, BOCOM Int'l estimates

Figure 3: Market panic at historical extremes (2020.03.13 intraday data)

Source: Bloomberg, BOCOM Int'l estimates

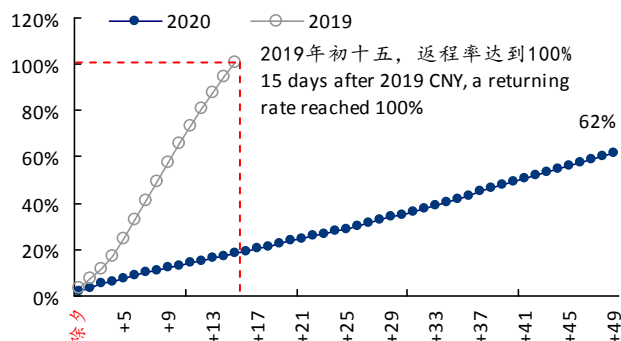
Figure 4: Foreign fund record outflow

Source: Bloomberg, BOCOM Int'l estimates

Figure 5: A50 index futures is still bound within a trading range since 2015

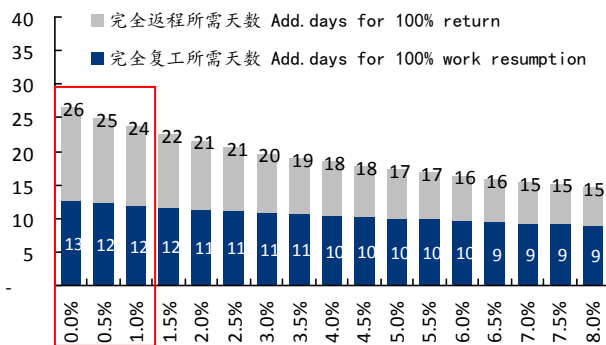
Source: Bloomberg, BOCOM Int'l estimates

Figure 6: Rate of people return at 62% nationwide



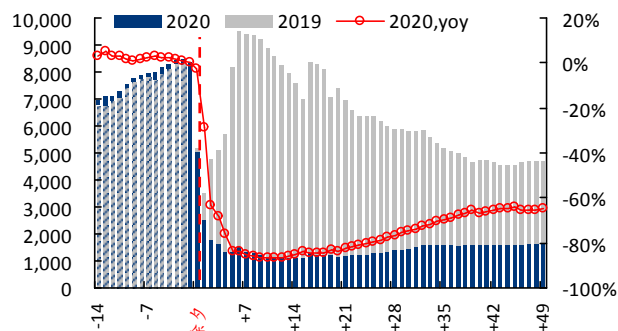
Source: Ministry of Transport, BOCOM Int'l (Data as of March 13, 2020)

Figure 8: Sensitivity estimates of the time needed for people's full return/work resumption. Current rate of work resumption is 77-88%



Source: Ministry of Transport, BOCOM Int'l The base date is March 13, 2020

Figure 7: Daily passenger grows at 0.4% dod on average, up slightly from last week



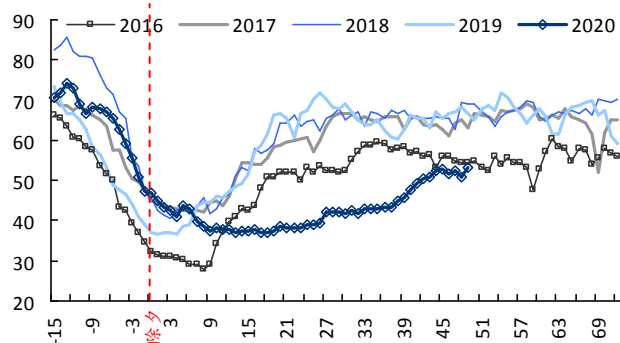
Source: Ministry of Transport, BOCOM Int'l (Data as of March 13, 2020)

Figure 9: Sensitivity estimates on work resumption progress. Full resumption of work will be achieved in late March (3.25-3.26)

完成日期 Completion date	3/14	3/15	3/16	3/17	3/18	3/19	3/20	3/21	3/22	3/23	3/24	3/25	3/26
客运增速(日均) Passenger growth ADR	79%	81%	83%	84%	86%	88%	90%	92%	94%	95%	97%	99%	~100%
0.00%	79%	81%	83%	84%	86%	88%	90%	92%	94%	95%	97%	99%	~100%
0.25%	79%	81%	83%	85%	86%	88%	90%	92%	94%	95%	96%	98%	~100%
0.50%	79%	81%	83%	85%	86%	88%	90%	92%	94%	95%	96%	98%	~100%
0.75%	79%	81%	83%	85%	86%	88%	90%	92%	94%	95%	96%	98%	~100%
1.00%	79%	81%	83%	85%	86%	88%	90%	92%	94%	95%	96%	98%	~100%
1.25%	79%	81%	83%	85%	86%	88%	90%	92%	94%	95%	96%	98%	~100%
1.50%	79%	81%	83%	85%	87%	88%	90%	92%	95%	97%	99%	~100%	
1.75%	79%	81%	83%	85%	87%	89%	91%	93%	95%	97%	99%	~100%	
2.00%	79%	81%	83%	85%	87%	89%	91%	93%	95%	97%	~100%		
2.25%	79%	81%	83%	85%	87%	89%	91%	93%	95%	97%	~100%		
2.50%	79%	81%	83%	85%	87%	89%	91%	93%	95%	97%	~100%		
2.75%	79%	81%	83%	85%	87%	89%	91%	93%	95%	98%	~100%		
3.00%	79%	81%	83%	85%	87%	89%	91%	93%	96%	98%	~100%		
3.25%	79%	81%	83%	85%	87%	89%	91%	93%	96%	98%	~100%		
3.50%	79%	81%	83%	85%	87%	89%	91%	94%	96%	98%	~100%		
3.75%	79%	81%	83%	85%	87%	89%	91%	94%	96%	99%	~100%		
4.00%	79%	81%	83%	85%	87%	89%	92%	94%	96%	98%	~100%		

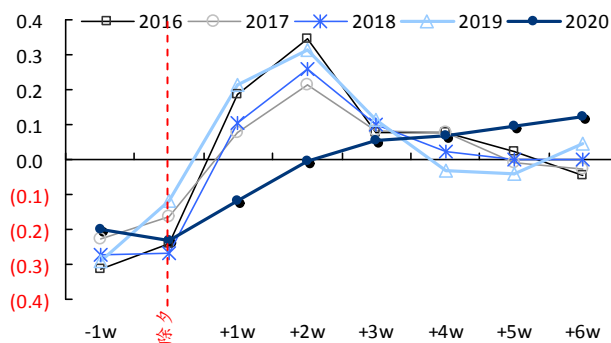
Source: Ministry of Transport, BOCOM Int'l The base date is March 13, 2020

Figure 10: Coal consumption for power generation rebounds to 80% for the same period last year



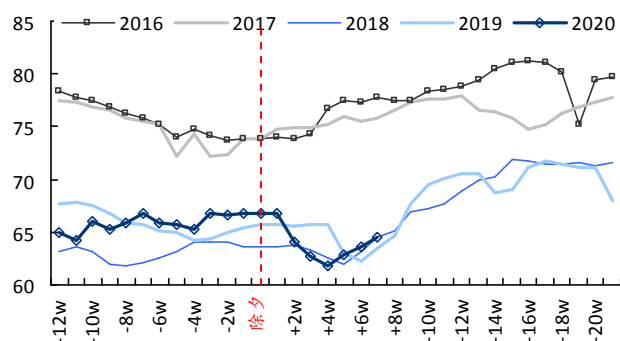
Source: Wind, BOCOM Int'l Data as of March 13, 2020

Figure 11: Coal consumption for power generation continues to increase WoW



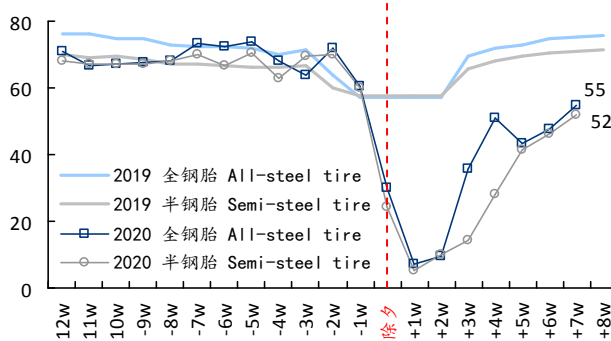
Source: Wind, BOCOM Int'l Data as of March 13, 2020

Figure 12: Blast furnace operating rate continues to rise



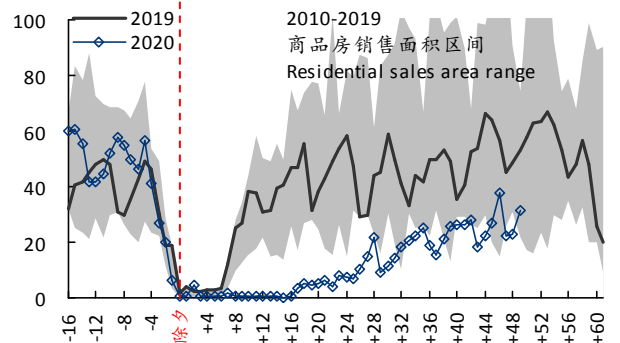
Source: Wind, BOCOM Int'l Data as of March 13, 2020

Figure 13: Car tire operating rate is recovering



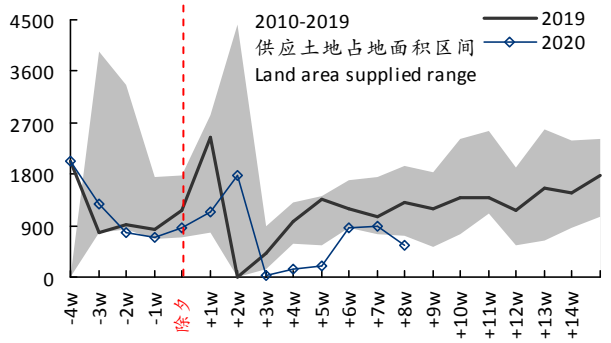
Source: Wind, BOCOM Int'l Data as of March 12, 2020

Figure 14: Property sales picked up



Source: Wind, BOCOM Int'l Data as of March 13, 2020

Figure 15: Land supply is gradually recovering



Source: Wind, BOCOM Int'l Data as of March 8, 2020

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Broad market benchmark for Hong Kong is the **Hang Seng Composite Index**, for China A-shares is the **MSCI China A Index**, for US-listed Chinese companies is **S&P US Listed China 50 (USD) Index**.

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