2022 China Macro and Equity Market Outlook

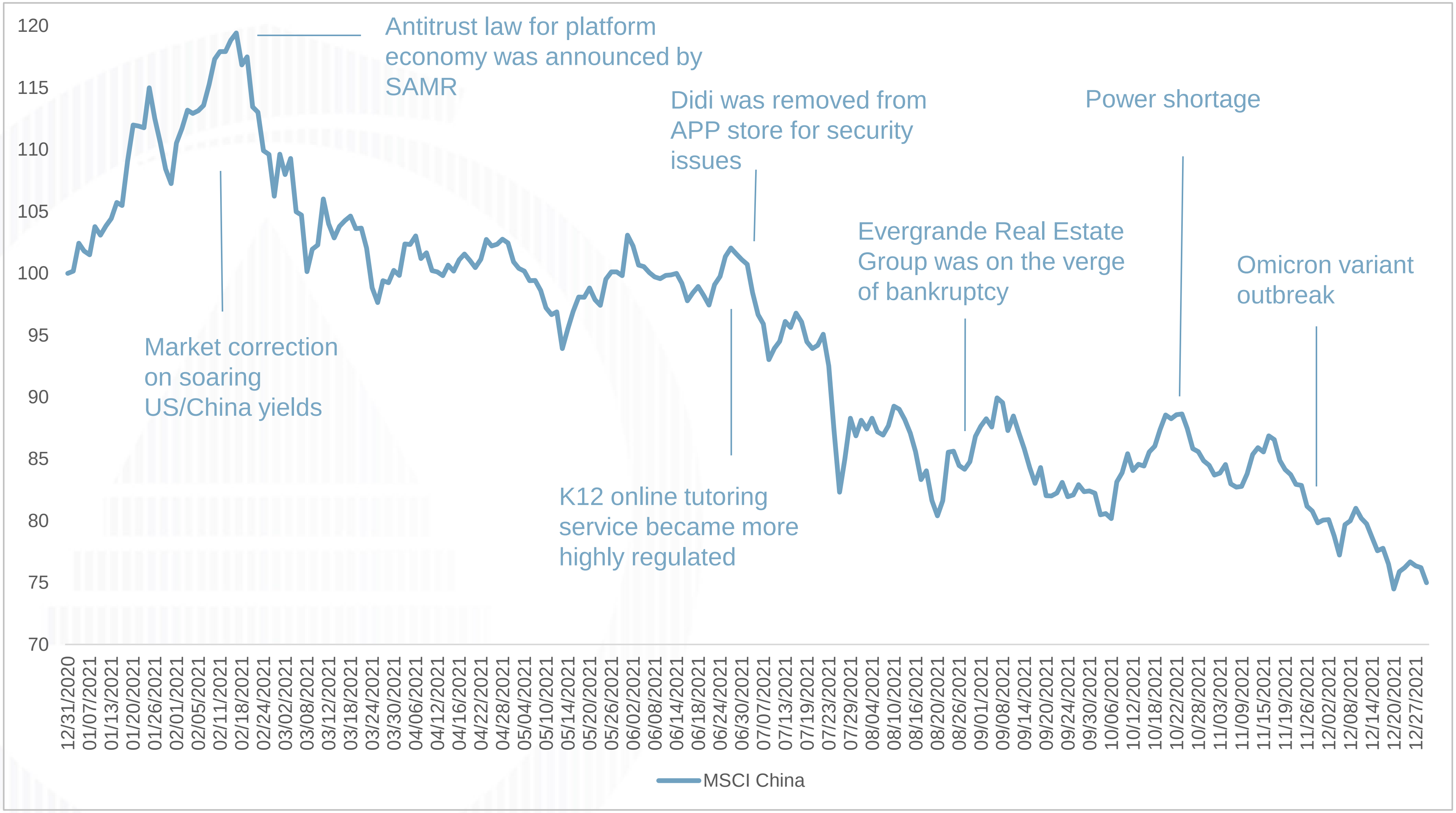
January 2022

ChinaAMC

2021 Equity Market Wrap

A tumbling year for China Equity

- China Equity started the year on a strong note, but suffered a series of drawdowns spurred by liquidity concerns, regulation tightening, real estate risk and power shortage among others.

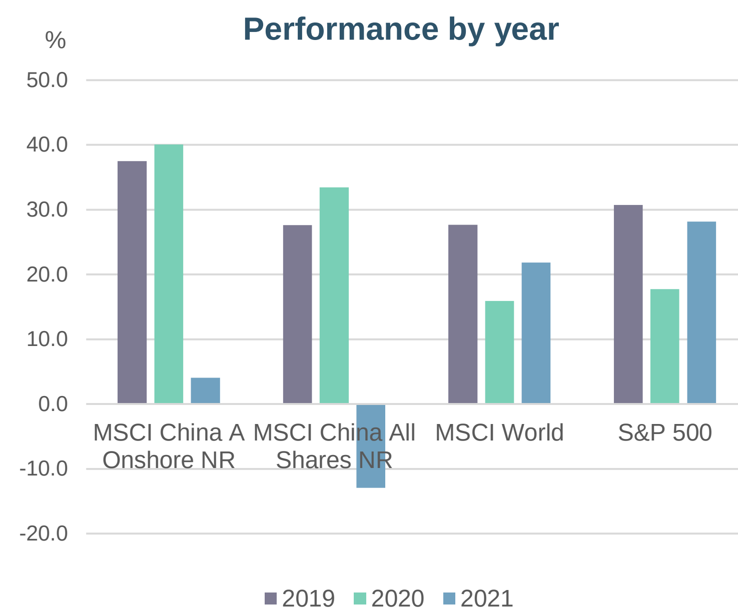


Source: FactSet, ChinaAMC. Index level rebased to 100 on 31 Dec. 2020.

ChinaAMC

…underperformed vs. global peers

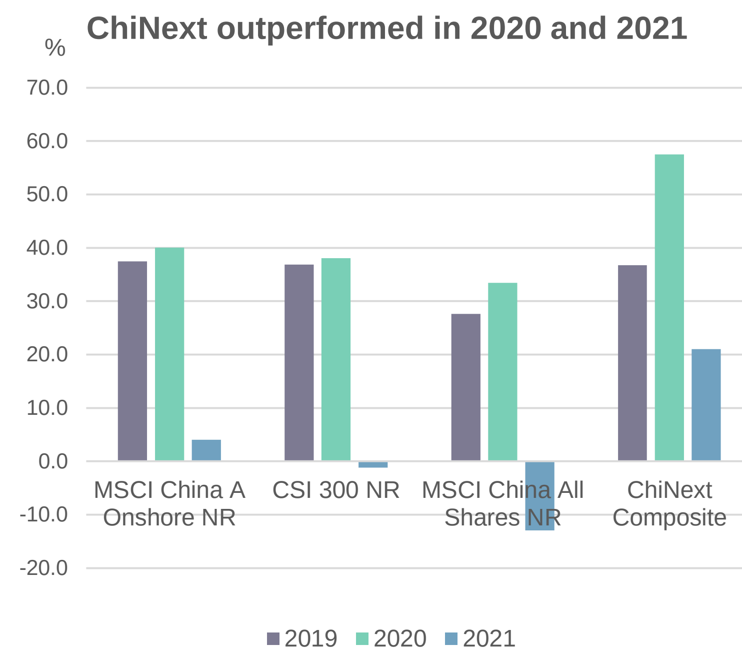
- **China Equity underperformed global DM peers in 2021** due to staggered pace of post-COVID recovery and concerns around tightening regulations, property market risks and an overall growth slowdown.
- **Offshore market underperformed onshore market since July**
  - The majority of Internet and education companies are listed in offshore markets.
  - Tightening scrutiny of offshore listings by SEC and CSRC cast additional uncertainties on Chinese ADRs.



Source: FactSet, ChinaAMC. Index level rebased to 100 on 31 Dec. 2020.

… yet still a year of momentum underpinned by onshore growth

- **Within the onshore market, Growth outperformed Value in 2021**
  - The divergence enlarged especially after May 2021 when macroeconomic growth weakened.



Source: FactSet, ChinaAMC. Index level rebased to 100 on 31 Dec. 2020.

Policy shocks haven't held back global investors

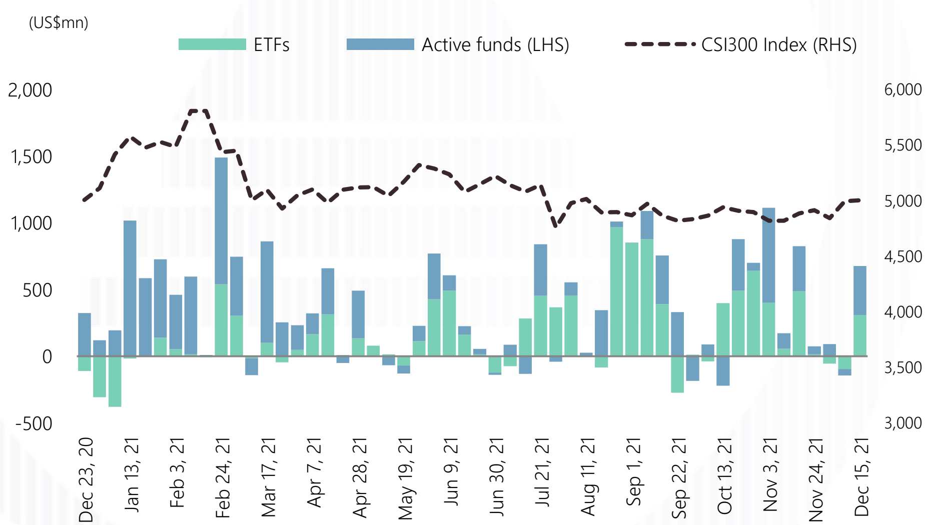
China-focused mutual funds domiciled overseas recorded **net inflows YTD**.

- Net inflow: US$ 10.7bn for A-share focused active funds, and US$ 7bn for H-share and ADR focused funds
- Inflow into ETFs speeded up in 2H 2021

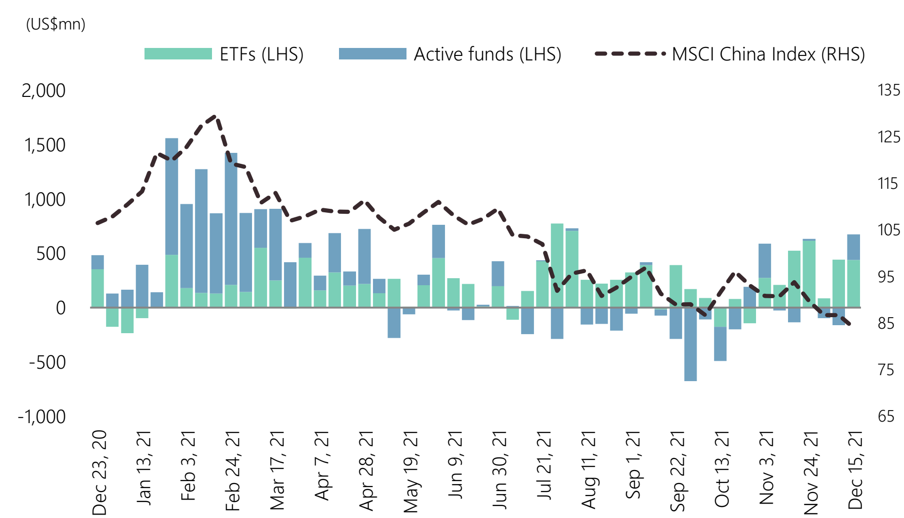
Net inflow of China funds domiciled overseas

Net inflow (in US$ billion)	A-share focused funds		H-share & ADR focused funds	
	Active	ETF	Active	ETF
2021	**11.2**	**9.5**	**6.9**	**11.5**
1H21	7.2	2.5	9.4	4.9
2H21	4.0	7.0	-2.5	6.7

Weekly net subscription of overseas A-share-focused funds



Weekly net subscription of overseas H-share & ADR-focused funds



Source: EFPR, CICC, ChinaAMC.
*Data ending 24 Dec 2021.

China Macro Outlook in 2022

Macro forecast in a nutshell - Resilient recovery with pro-growth policies

- **We forecast GDP to grow 5.3% in 2022E**
  - Slightly below pre-pandemic pace of growth (around 6.0% YoY), primarily due to a potential property market downturn, and prolonged COVID uncertainties.
- **Policy environment is more growth-supportive**

Snapshot of macro forecasts

YoY Growth (%)	2019A	2020A	2021E	2022E
GDP	6.1	2.3	*8.1*	*5.3*
Nominal GDP	7.3	3.0	*13.3*	*8.0*
Industrial output	5.7	2.8	*9.6*	*5.0*
Fixed asset Investment (FAI)	5.4	2.9	*4.4*	*4.8*
Manufacturing FAI	3.1	-2.2	*3.8*	*7.0*
Real Estate FAI	9.9	7.0	*5.5*	*0.0*
Infrastructure FAI	3.8	0.9	*1.0*	*4.8*
Retail sales	8.0	-3.9	*4.3*	*6.5*
Export	0.5	3.6	*27.0*	*5.0*
CPI	2.9	2.5	*1.0*	*2.3*
PPI	-0.3	-1.8	*8.0*	*3.5*
M2	8.7	11	*8.2*	*8.8*
Total Social Finance	10.7	13.8	*10.3*	*10.7*
USDCNY (End of period)	6.97	*6.53*	*6.40*	*6.50*

- **Main growth drivers**
  - Ramping up of green investment
  - Rebound of infrastructure investment owing to more proactive fiscal policies
  - Consumption strengthening

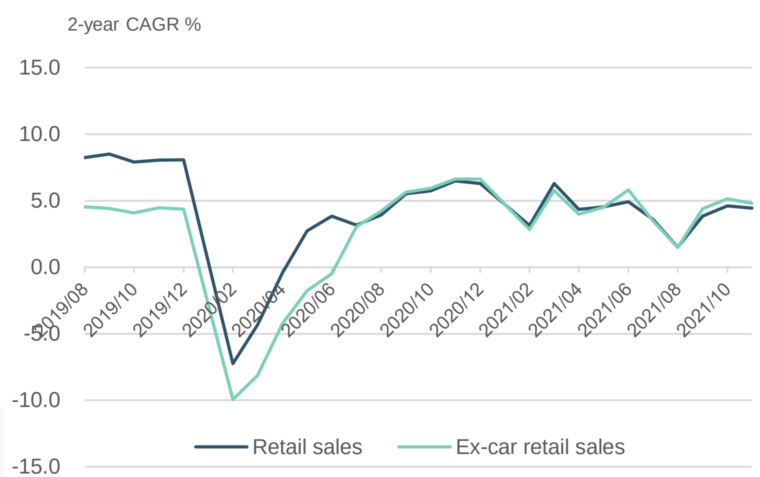
- **Primary risk factors**
  - Property market downturn
  - COVID uncertainties and restrictions dragging consumption recovery
  - Geopolitical tensions

Source: NBS, Wind, ChinaAMC estimates

Consumption – expect marginal rebound

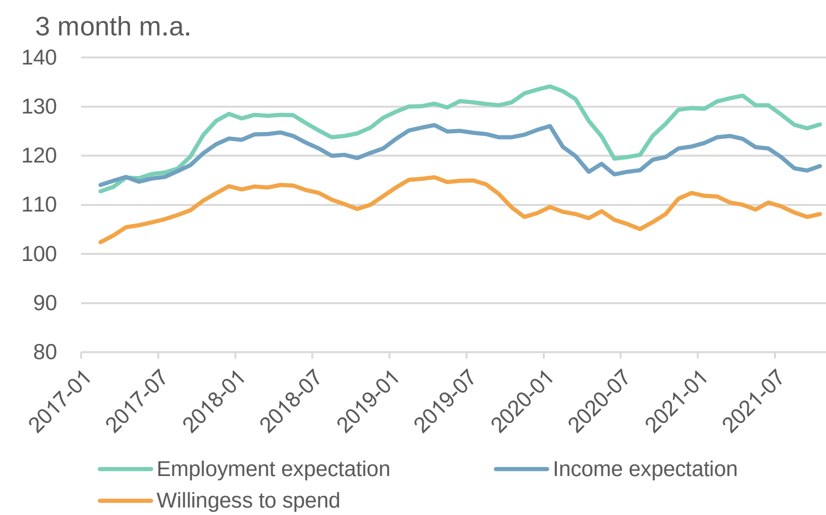
- Retail sales is expected to **strengthen on 2021's low base**, but the pace of rebound is contingent upon COVID restriction policies.
- In the near term of 1Q22, however, we may continue to observe some factors inhibiting consumption growth
  - COVID restrictions around the Winter Olympics
  - Structural tensions in the job market (layoffs or pay cuts) as ramifications of previous Internet and education regulations. Consumer survey showed that expectations of employment and income growth dipped since early 2021 but have started to show signs of stabilization.

Retail sales growth still 3-4ppt below pre-pandemic level



Source: NBS, Wind, ChinaAMC

Consumer sentiment plunged since early 2021, but has started to stabilize

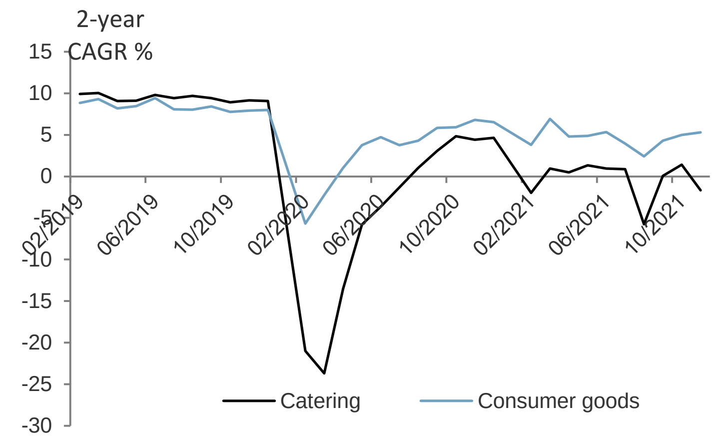


Source: NBS, Wind, ChinaAMC

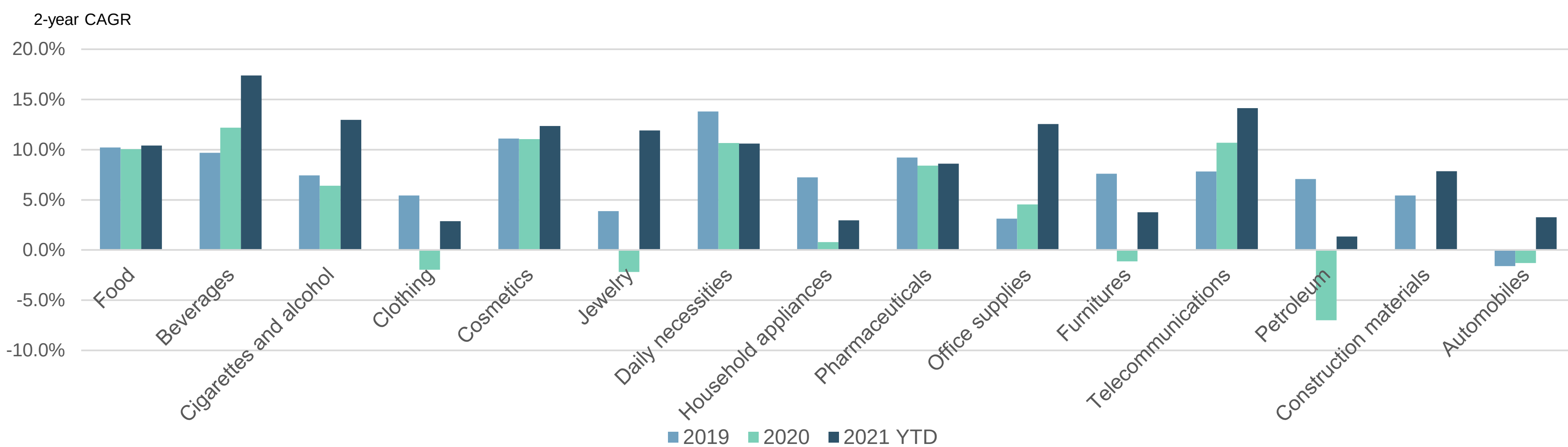
Consumption – expect marginal rebound (cont'd)

- Pent-up demand may drive an uptick in catering, travel or other service consumptions after COVID restrictions are relaxed.
- However, we do not expect significant rebound of retail sales because most of the pent-up demand for large-ticket items (automobiles, home appliances, etc.) has already been consumed in 2020-21.
- Decelerating home sales is also weighing on consumption of housing-related items, such as home appliances and furniture.

Catering revenue growth still far below pre-pandemic levels



Retail sales growth by categories of items



Source: NBS, Wind, ChinaAMC

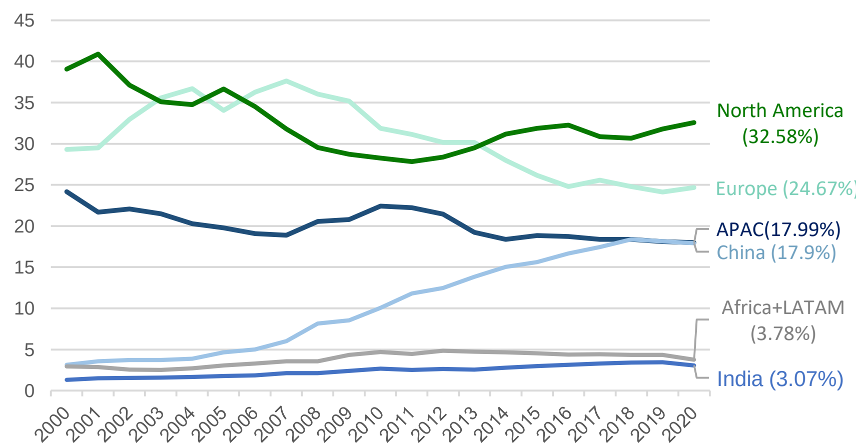
Common Prosperity helps boost domestic demand in the long run

- **"Common Prosperity" is not a new theme.** It is part of the decades-long journey China has embarked on since the 1980's, from "letting some people get rich first", to "help other people in poorer regions" and finally to "achieve common prosperity".

- It deals more with **enlarging the pie**, rather than transferring wealth from the rich to the poor in the narrow sense.
  - Sitting at the core of the Common Prosperity plan are targets to increase income of residents, expand the middle-income group, and ensure better and fairer access to public goods and services.
  - It is a plan of addition or creation rather than subtraction or substitution.

China's share of global wealth is rising

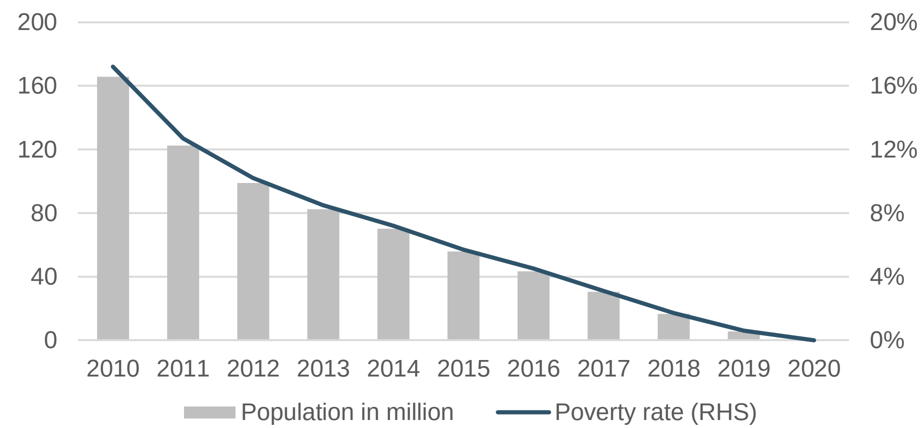
Share of global wealth, %



Source: Credit Suisse Global Wealth Report 2021, ChinaAMC

China has eliminated absolute poverty in the past decade

Rural population in poverty (by 2010 standard)



Source: Wind, ChinaAMC

Investment

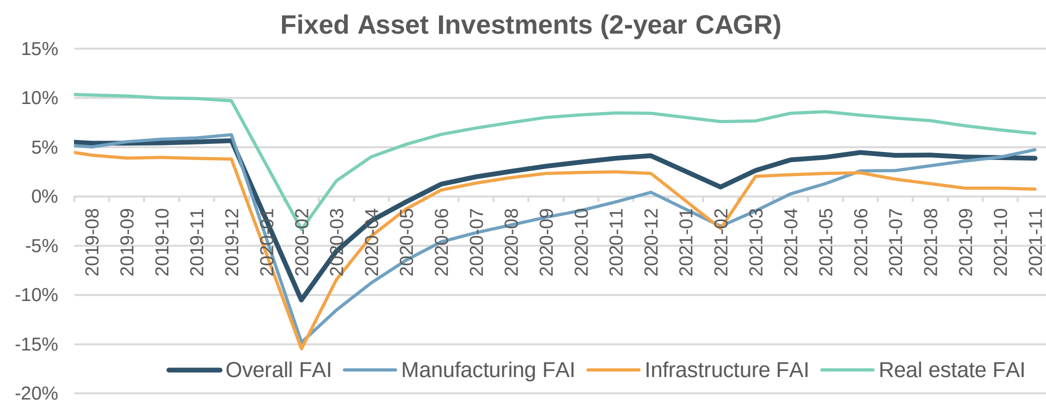
- Real estate investment is likely to dip in 2022E, but we expect investment driven by green initiatives and technology innovation to step up.
- **Carbon Neutrality blows in a new wave of green investment**
  - At least RMB 100 trillion of capital is estimated to be invested in the next 30 years.
  - Green initiatives not only require government sponsored investment, but also involve private capital participation. This multiplier effect will drive broad-based economic growth and bring along substantial investment opportunities.
- **Manufacturing investment is also gaining momentum, particularly driven by high-tech industries**

Green investment estimation

	Tsinghua University	Goldman Sachs	CICC	GFC Research Group	IAC
Estimated investment (Rmb)	174 Trillion	104 Trillion	139 Trillion	487 Trillion	70 Trillion
Forecast Period	2020-2050	2021-2060	2021-2060	2021-2050	2020-2050
Industry Coverage	Low-carbon energy related fields			211 sub-industries such as low-carbon and ecological environmental protection	Green Infrastructure, transmission channel (￥20tn), Photovoltaic and wind power (￥25tn)
Investment Coverage	Fixed-asset investments only			Include fixed-assets and the demand of working capital	

*GFC: Green Finance Committee, China Society for Finance & Banking.
*IAC: The Investment Association of China

Manufacturing FAI is gaining momentum

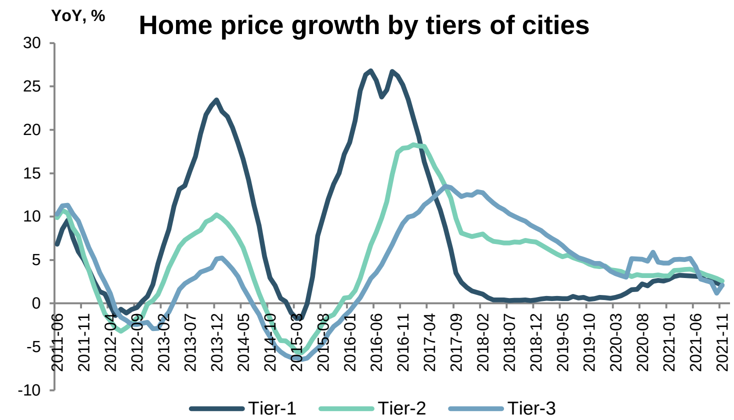


Source: NBS, Wind, ChinaAMC

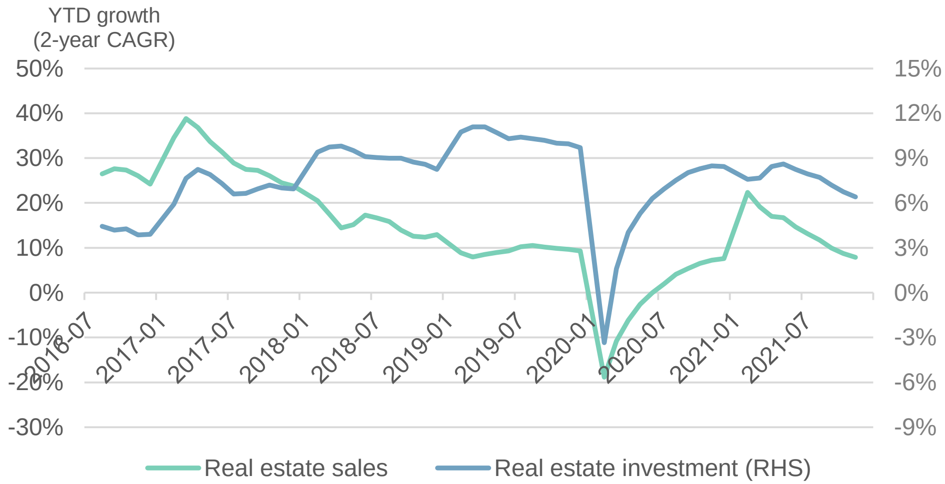
ChinaAMC

Real estate: entering a downturn but manageable

- **The property market is entering a downturn**
  - We estimate YoY growth of property development investment to be -5% to 0% in 2022E.
- **…but we believe the downturn is manageable**
  - Though being determined not to rely on real estate to stimulate growth, the government also has incentives to prevent risk spillover from the property market to the broader economy.
  - In this regard, both central and local governments have policy tools to mitigate risks and we have already observed some marginal loosening of credit supply to the property market.



Real estate sales & inv. may dip further in 2022



Weakness of the real estate sectors has been reflected in stock performance

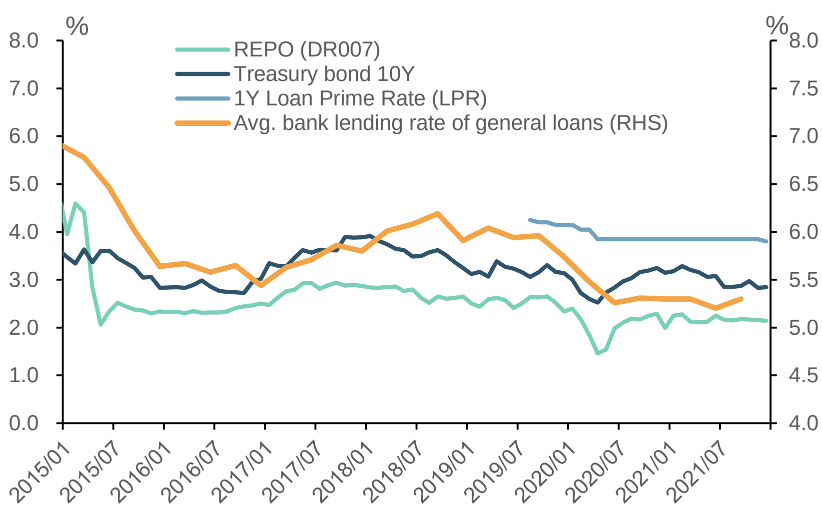
Source: NBS, Wind, ChinaAMC calculation

Source: Wind, ChinaAMC
* Index level on 4 Jan 2016 rebased to 100.

Pro-growth policy environment

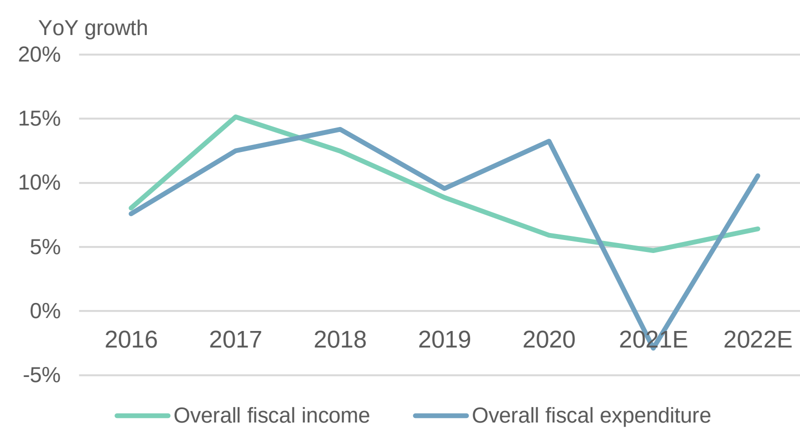
- **The overall policy environment is expected to become more growth-supportive in 2022**
- **Regulatory risks that drove market swings in 2021 will be alleviated in 2022**, after related regulations and laws have already been established regarding anti-monopoly, data security and personal information protection.
- **Monetary policy – reducing financial cost of the real economy is paramount**
  - More explicit support for SMEs, technological innovation and green development.
  - Softer tones regarding credit support for property market and local government financing vehicles to prevent a deep downturn.
- **Fiscal policy** – fiscal expenditure will accelerate in 2022E and most of the local governments have already finished leadership transition.

The PBoC further guided down LPR in Dec 2021 to reduce bank lending rate



Source: PBoC, Wind, ChinaAMC

We estimate overall fiscal expenditure to increase 10%+ in 2022E



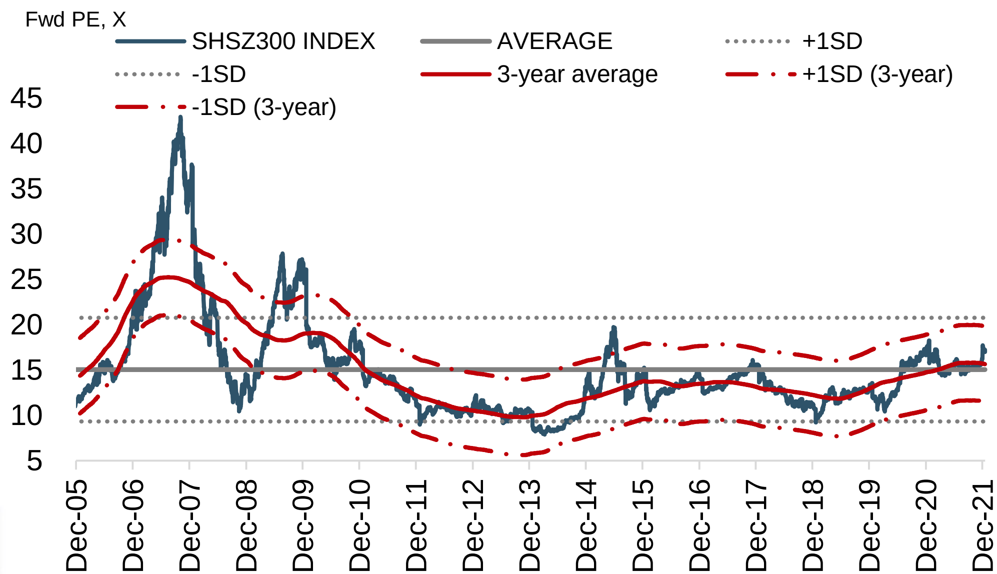
Source: Ministry of Finance, ChinaAMC estimates

China Equity Market Outlook in 2022

Onshore market: Moderate upside driven mostly by earnings growth

- Our base case forecast: **10%** EPS growth for all A-shares in 2022E, a moderate slowdown from c.15% in 2021E.
  - Our in-house estimate is a bit lower than market consensus primarily because we are more conservative about earnings growth in the financials and the real estate sectors.
- We forecast **10%** upside for the A-share market driven by EPS growth, assuming minimal valuation expansion.
  - CSI 300 is roughly trading at 3-year average forward P/E. Current valuation is undemanding.
- Market style may tilt toward Growth stocks and stocks with high dividend yields.
  - Sectors with visible and sustainable growth, such as renewable energy and advanced manufacturing, are likely to outperform. Although some high-growth sectors are becoming crowded, we think it is still possible to seek alpha opportunities along the value chain and in less popular names.

CSI300 P/E



Source: Bloomberg, ChinaAMC

Downside cushions

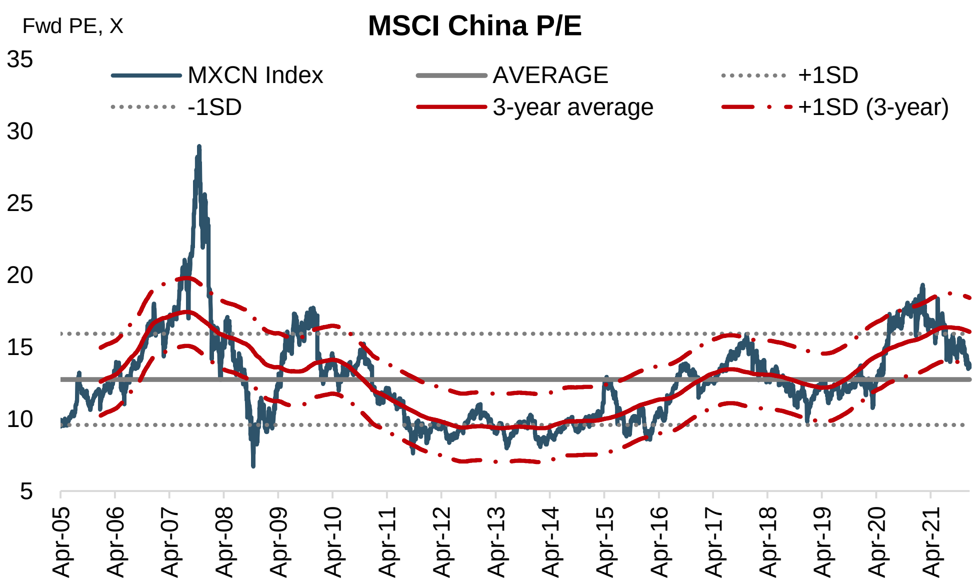
- Pro-growth policy environment
- Relatively ample liquidity
- Less stringent regulations

Upside catalysts

- Earnings surprise
- Re-rating opportunities

Offshore China market: looking for re-rating opportunities

- We also stay positive about overseas China equity market in 2022. We expect:
  - Only mild earnings deceleration rather than sharp corrections
  - Regulatory headwinds are waning
  - There exist chances for re-rating given relatively low valuation. MSCI China is currently trading below 3-year average minus 1 STD forward P/E.
- On the flip side, downside risks primary include:
  - Fed rate hike
  - Lack of liquidity support in Hong Kong market when secondary/dual listing of ADRs expedites



Source: Bloomberg, ChinaAMC

Consensus EPS estimate – no sharp decline in earnings

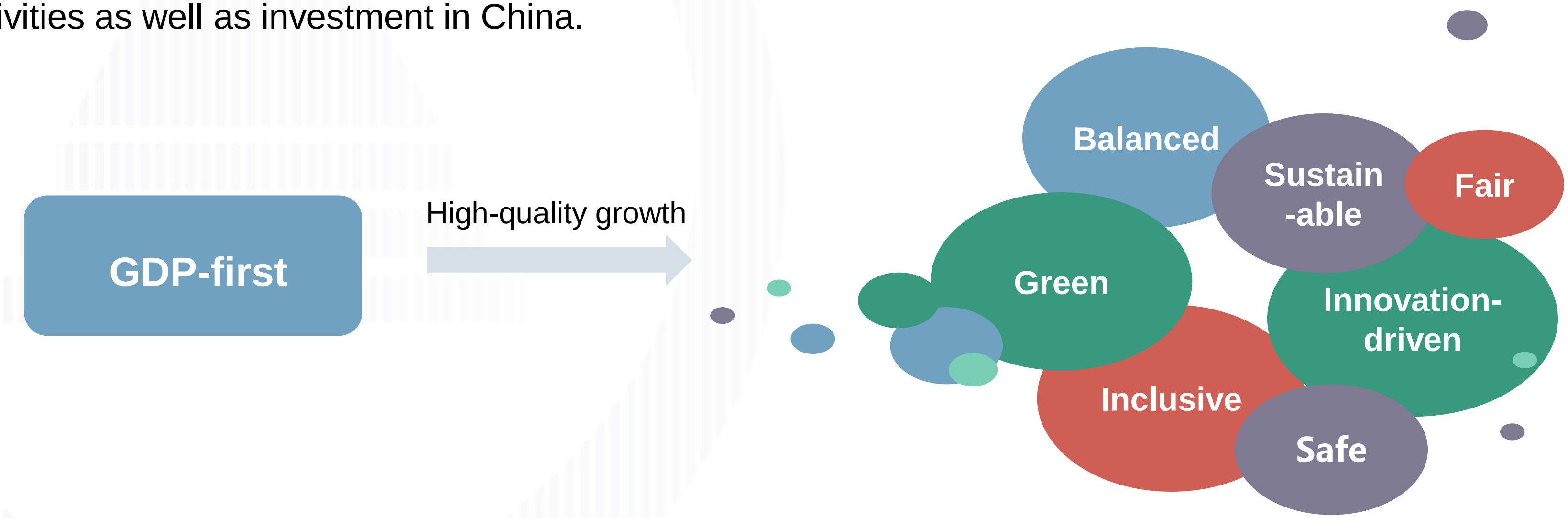
	EPS growth consensus estimate		
	2021E	2022E	2023E
CSI 300	19.6%	18.0%	14.5%
MSCI China	16.5%	12.8%	15.3%
MSCI China A Onshore	25.3%	20.0%	15.9%

Source: FactSet

ChinaAMC

High-quality growth is the new backdrop for investment

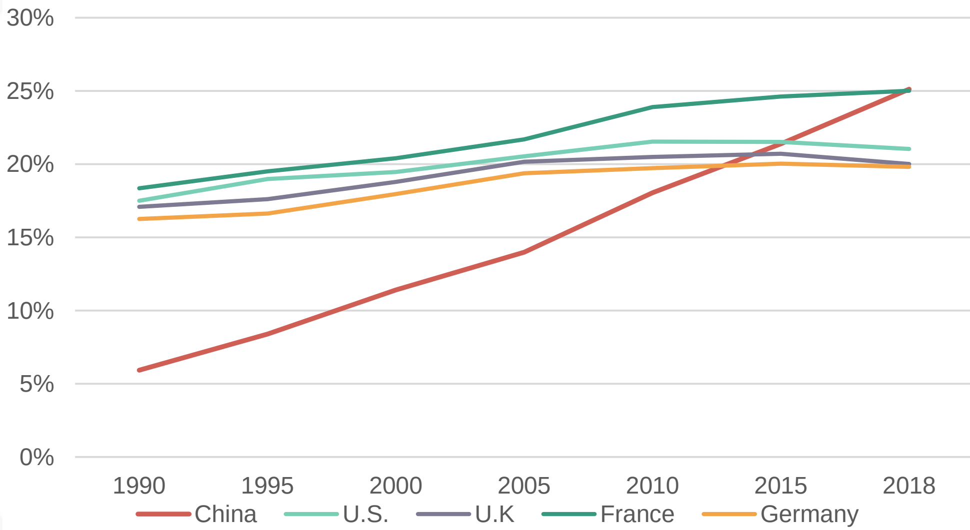
- At the beginning of 2021, it was hard to predict what was going to happen in 2021. The entire K12 education industry has been overhauled, share prices of e-commerce companies like Alibaba and PDD dropped by 50-70%, high-end consumption stocks like Wuliangye and China Duty Free plunged by 30-40% from the peak, on concerns of tightening policies which aimed to reduce inequality, regulate monopoly behaviors, and promote common prosperity.
- However, we have no doubt that China will successfully transform from an investment-driven and export-driven economy to a domestic consumption and innovation-driven economy. We believe that China's economy will become greener, smarter and more sustainable than ever before.
- The transition from "GDP-first" to high-quality growth emphasizes innovation, green & sustainable development, balanced growth, and inclusiveness among others. This paradigm shift constitutes the backdrop of future business activities as well as investment in China.



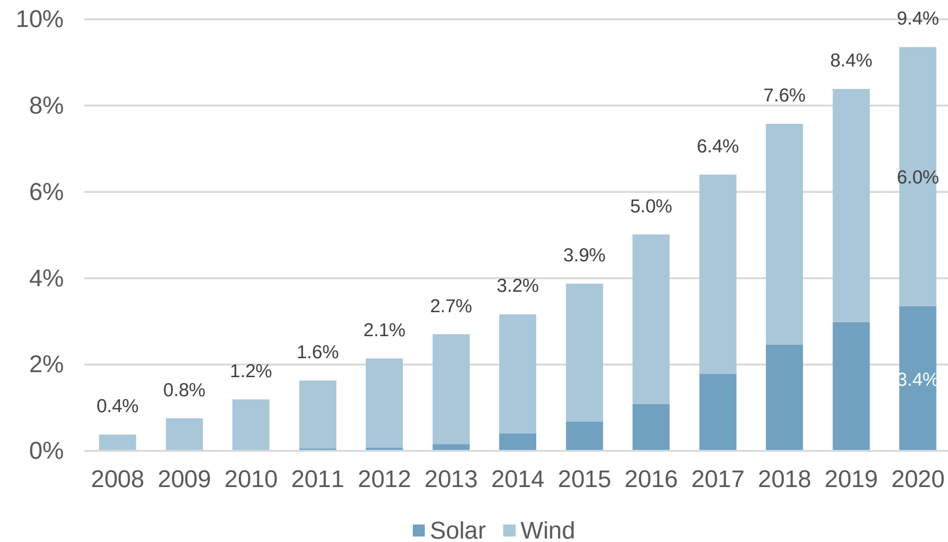
We are positive about the renewable energy sector

- Renewable energy is playing a much more important role in the economy than ever before. China's energy industry is experiencing some fundamental changes: 1) electrification is accelerating, 2) renewable energy will account for more than 50% of total electricity generation by 2050, and 3) power grid is becoming smart and decentralized. We can find more investment opportunities from this mega trend.

Electrification share*, across countries



Share of electricity generated from solar and wind, China

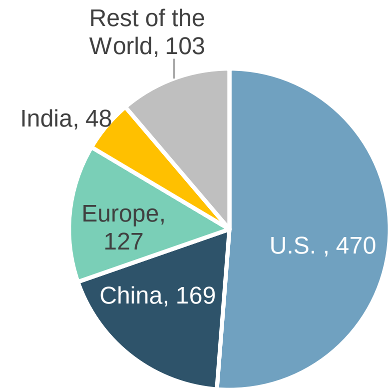


Source: BP Statistical Review of World Energy (2020), ChinaAMC
Note: Electrification share is the share of electricity in final energy consumption.

We are also bullish on high-tech industries

- **High-technology is another space that we are interested in**
  - China is gradually moving up the global value chain, from a manufacturer to an innovator. Chinese companies are becoming leading players in a few areas such as renewable energy, electric vehicles and AI.
  - As of Nov 2021, China is home to 169 global unicorns, second only to the U.S..
  - Import substitution and the push for developing resilient supply chain will also expedite development of domestic technology companies.

Number of unicorns across the globe

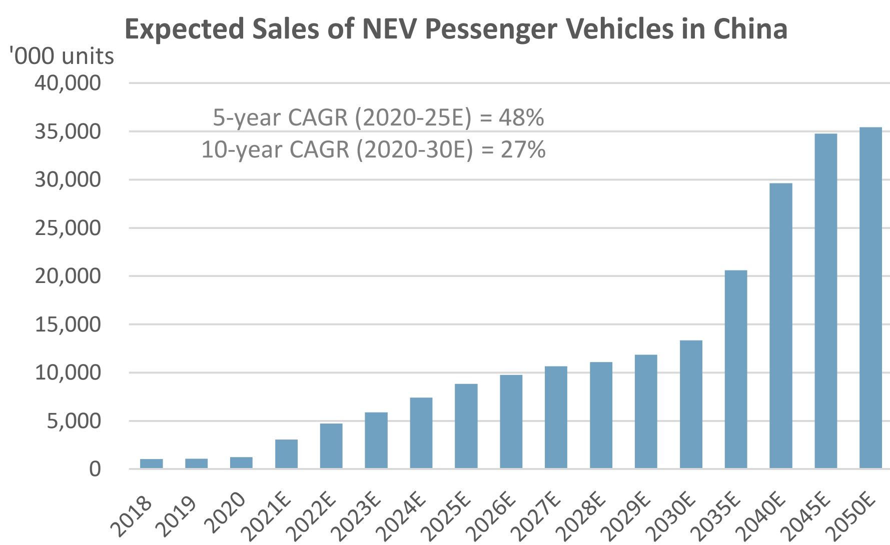


Source: CB Insights, ChinaAMC.
*A unicorn company is defined as a private company valued over US$ 1bn.
Data as of November 2021

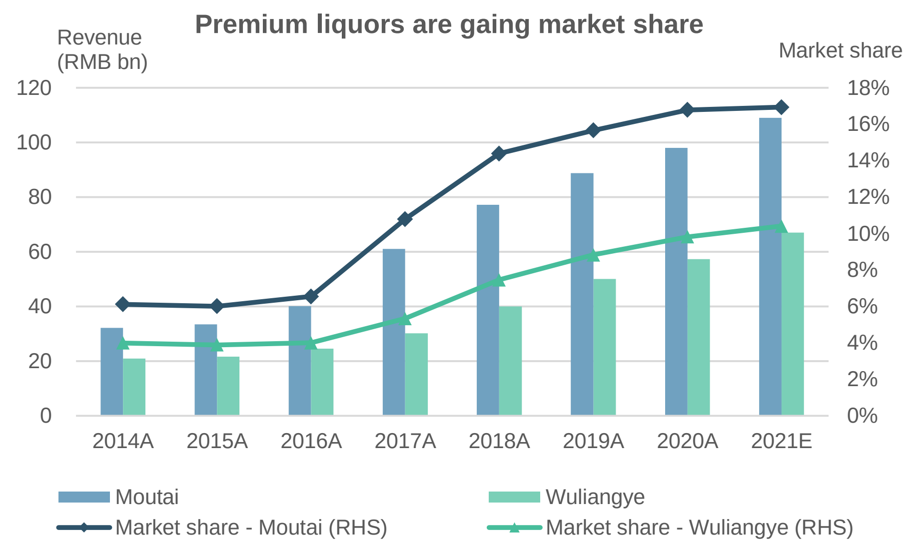
- **Blurring of industry boundaries gives rise to new investment opportunities**
  - Both traditional IT companies and Internet giants are doing cloud computing; smart phone makers like Xiaomi is planning to build its own smart EV car; traditional manufacturers are implementing industrial 4.0 control systems and AIoT, and IT companies like Huawei is teaming up with solar panel makers to design and build smart grid system. We are closely monitoring these trends, trying to understand the underlying reasons, and hope to pick out the winners.

Stay selective in the consumer sector

- Consumption growth may face some short-term pressures due to COVID restrictions, slack wage growth, etc.. However, we still believe that the consumption upgrade is a decade-long trend.
- We also expect a moderate rebound in consumption growth since 2Q 2022. Earnings growth of consumer names is likely to accelerate on higher topline growth, lower costs (owing to CPI catching up to PPI), and a relatively low base.
- We stay positive about the following consumption subsectors:
  - New Energy Vehicles – to benefit from the booming demand for NEVs in China.
  - Premium liquors – beneficiary of consumption upgrade. Stock prices of premium liquors have consolidated in 2021. Current valuations provide a better risk-adjusted return compared to one year ago.



Source: Marklines, CICC, ChinaAMC.



Source: NBS, Company reports, ChinaAMC forecast

We anticipate challenges in the following sectors

- We are less positive regarding Financials and Real Estate sectors without foreseeing any meaningful rebound of macroeconomic conditions
  - Financials – NIM pressures for banks.
  - Real estate – a potential downturn in property sales and investment.
- We also remain neutral about the Healthcare sector
  - Lack of earnings visibility under the centralized procurement scheme.
  - However, demand for healthcare services is expanding over the long run. We will be closely following the healthcare sector to wait for an entry point.

Summary

- We anticipate stabilizing economic growth in 2022 under growth supportive policies
  - Forecast GDP to grow 5.3% in 2022E
  - Highlights: green investment, infrastructure investment and consumption strengthening
  - Risks: property market slowdown, COVID uncertainties and geopolitical tensions
- We stay positive about China's equity market
  - Owing to pro-growth regulatory environment, liquidity support and resilient earnings growth
  - Base case: 10% upside for A-shares driven by earnings growth, assuming minimal valuation expansion. Overseas market may have better chances for re-rating given low valuation.
- Sector views
  - Positive: renewable energy, high-tech industries; high dividend yield stocks
  - Cautiously optimistic: consumer sectors
  - Cautious: Financials, Real estate, Healthcare

China Asset Management Co., Ltd.

9th Floor, Tower 7, One Yuetan Street South
Xicheng District, Beijing, 100045, China

Email: ib@chinaamc.com
Tel: +86 10 8806 6116

Important Information