

Latest Market Analysis and Investment Strategy - October, 2016 Report

September Headline

The World Bank on Wednesday issued landmark bonds denominated in special drawing rights (SDR) in China's interbank market. The three-year bonds worth 500 million SDR (\$700 million) were billed as "Mulan bonds." The Chinese currency the yuan, or renminbi, will be used as the settlement currency.

China relaxed quotas for qualified foreign institutions to invest in its stock market on Monday, in the country's latest efforts to open up its financial sector. Foreign investors in the country's Renminbi Qualified Foreign Institutional Investor (RQFII) program will be granted quota limits based on their aggregate assets.

China's securities watchdog is considering more support for green financing via the capital market to help the transition to greener growth, according to a senior researcher. More capital market support could help channel money into environmentally friendly sectors.

Chinese banks saw their net foreign exchange sales dropped by 70 percent from July to \$9.5 billion in August, official data showed Monday. Chinese lenders bought \$125.7 billion worth of foreign currency last month and sold \$135.2 billion.

China's outstanding foreign debt returned to growth in the second quarter as companies' deleveraging process drew to a close, the country's foreign exchange regulator said Tuesday. The debt settled at \$1.39 trillion at the end of June, up 2 percent from a quarter earlier. The increase reversed a falling trend seen since the second quarter of 2015. On a quarterly basis, the debt dropped 3.6 percent at the end of March and declined 7.4 percent at the end of 2015.

Economic Indicator Analysis

Inflation Rate

Consumer prices in China rose 1.3 percent year-on-year in August of 2016, compared to a 1.8 percent rise in July while market expected a 1.7 percent increase. It was the lowest inflation rate since October 2015 as the politically sensitive food prices increased by 1.3 percent while non-food cost rose at a faster 1.4 percent. Cost of consumer goods gained 0.9 percent and those of services advanced 2.1 percent. On



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a monthly basis, consumer prices rose 0.1 percent, after gaining 0.2 percent in a month earlier and below market consensus of a 0.3 percent growth.

Trade Surplus

China reported a USD 52.05 billion trade surplus in August of 2016, compared to a USD 59.68 billion surplus a year earlier and below market estimates, as exports fell less than expected while imports rose for the first time in 22 months. In August, exports declined by 2.8 percent year-on-year, following a 4.4 percent drop in the preceding month and market consensus of a 4.0 percent drop. Imports unexpectedly increased by 1.5 percent, compared to a 12.5 percent decrease in July, while markets expected a 4.9 percent fall. In yuan-denominated terms, sales grew by 5.9 percent from a year ago, following a 2.9 percent rise in July while inbound shipments went up 10.8 percent, compared to a 5.7 percent decline in the preceding month. In July 2016, the country registered a USD 52.31 billion trade surplus.



China Money Supply M2

Money supply M2 in China increased by 11.4 percent from a year earlier to 151.1 trillion yuan in August 2016.



October Stock Market Outlook

China's A Share Market

In September, we insist that the market has carried out a moderate adjustment. Before the National Day, The decline in market volume reflects the investor sentiment, but we believe that the market is warmer. We are optimistic about the performance of the market in October.

In overseas aspect, the U.S. economic recovery is not strong, it does not support to increase interest rate. If the U.S. increases interest rate in December, we insist that the only one before the end of 2017. In addition, we believe that the devaluation pressure of RMB is not very huge, the market is not focus on RMB, instead of pound.

In the domestic aspect, CPI has a tendency to rebound from the bottom. the growth of industrial enterprises continued to improve. The 350 billion restructuring of state-owned enterprises fund was established; it means the reform of state-owned enterprises to release positive signals. During the National Day's holiday, the real estate policy was released intensively, that will lead to the capital flows into the A-share market.

HK Stock Market

Hong Kong's stock market trended upwards for three straight months on increasing trading volume. Hang Seng Index climbed 1.4% in September and 12.0% in the third quarter. The average daily turnover of the stock market increased by 8% to \$74 billion last month, the highest since January 2016. Mainland investors continued to snap up Hong Kong equities; net inflow in southbound trading via Shanghai-HK Stock Connect hit a record high of \$59.0 billion in September.

We maintain positive outlook in the medium term. Among the reasons to stay bullish is the potential fund inflow from mainland insurance companies following a recent policy change. It is still a grey area for insurance asset management companies to invest in HK through stock connect. They are currently trading HK stocks by investing in some stock connect funds. We believe once the new policies are in place, the insurance companies will start buying Hong Kong stocks.

Also, the Chinese economy witnessed signs of stabilization in August and September providing a fundamental support to share prices of Hong Kong stocks. Imports grew 1.5% yoy in August, a positive growth for the first time since October 2014. Manufacturing sector moved back into an expansionary mode with manufacturing PMI rose to 50.4 in both August and September, the highest since October 2014.

In conclusion, the emerging signs of stabilization in China's economy, the potential fund inflow from mainland insurance companies, and launch of Shenzhen-HK Stock Connect will provide a cushion for the HK stock market.

The failure of Hang Seng Index to stand above 24,000 in September despite a record high net inflow of funds from China indicates 24,000 point is a strong resistance level. In the short term, the downside risk is not high, but the index also lacks upside potential. We therefore expect Hang Seng Index to hover between 23,000 and 24,300 in October.

