

Horizon Insights China Talk

Overcoming Economic Pessimism

——A tipping point or a turning point?

Don Ma

2022/11

- **Market Strategy**
- **New Energy**
- **Consumer**
- **Healthcare**

About Us

Horizon Insights, founded in April 2015, is a Chinese institutional research firm providing investment research services to both global and Chinese institutions. We are a leading independent firm in China and work with clients to track China's economy on a real-time basis, corroborate developments on the ground, and formulate, implement and monitor China-related investment theses and strategies. Our research lines include:

- 1. Macroeconomic and commodity analysis**
- 2. Equity research by industry (tech, consumer, health care, and new energy)**
- 3. 'On The Ground' research and company surveys**

Within China, we primarily serve the country's asset management firms including mutual funds, hedge funds, and corporates. Our domestic clients account for over 90% of assets under management in the Chinese fund industry. We are the largest independent research provider covering the China A-Share market and China-related commodities market.

Outside of China, we have actively provided research services to global buy-side institutions since 2016. We have sales teams in the U.S. and Singapore expanding to meet the needs of our growing client base and currently work with some of the largest global asset managers.

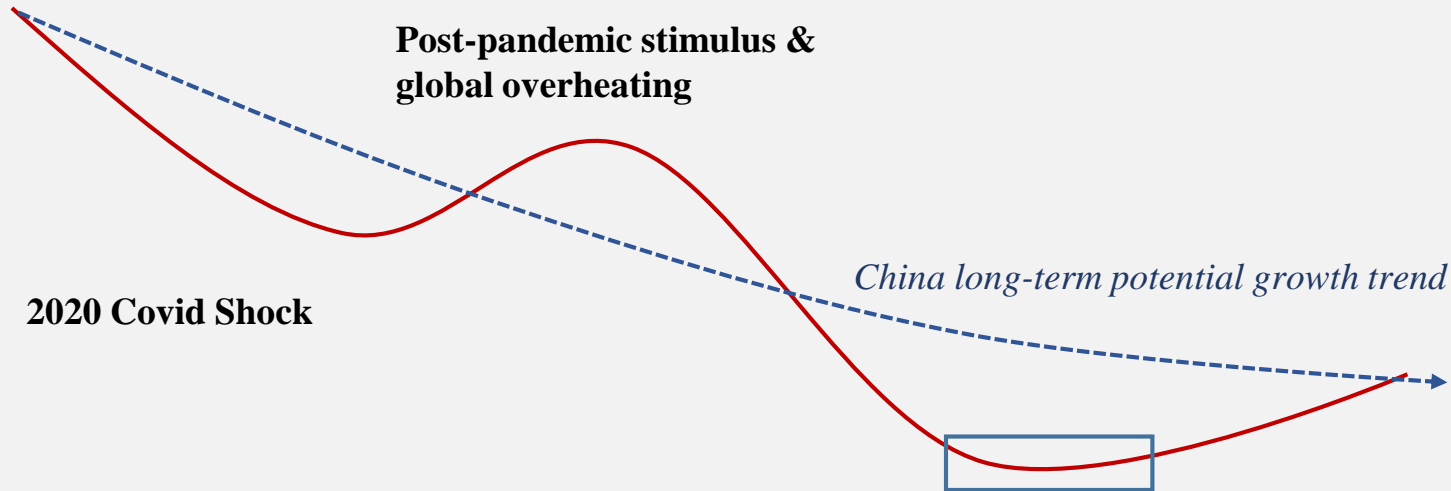


01

China's Economy: the underlying power for long-term growth

What is the potential growth rate of China's economy?

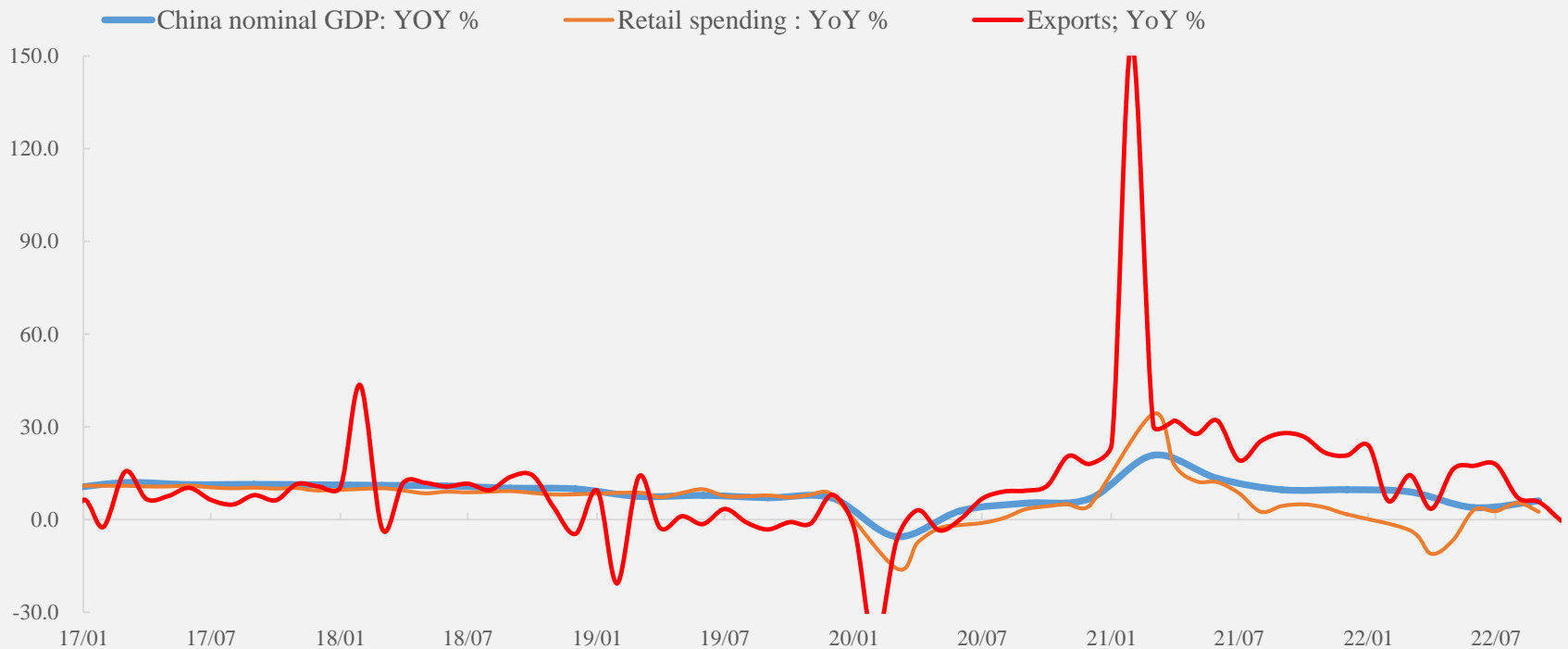
- China's long-term trend growth rate is slowing down from 8% in 2010 to 5% in 2020.
- Yet China has not reached the state of Japan in 1990 due to the improvement of labor force.



Global reopening v.s. China Covid Resurgence:
price pressure and diminishing demand due to policy normalization

Export-driven economic growth stage is over

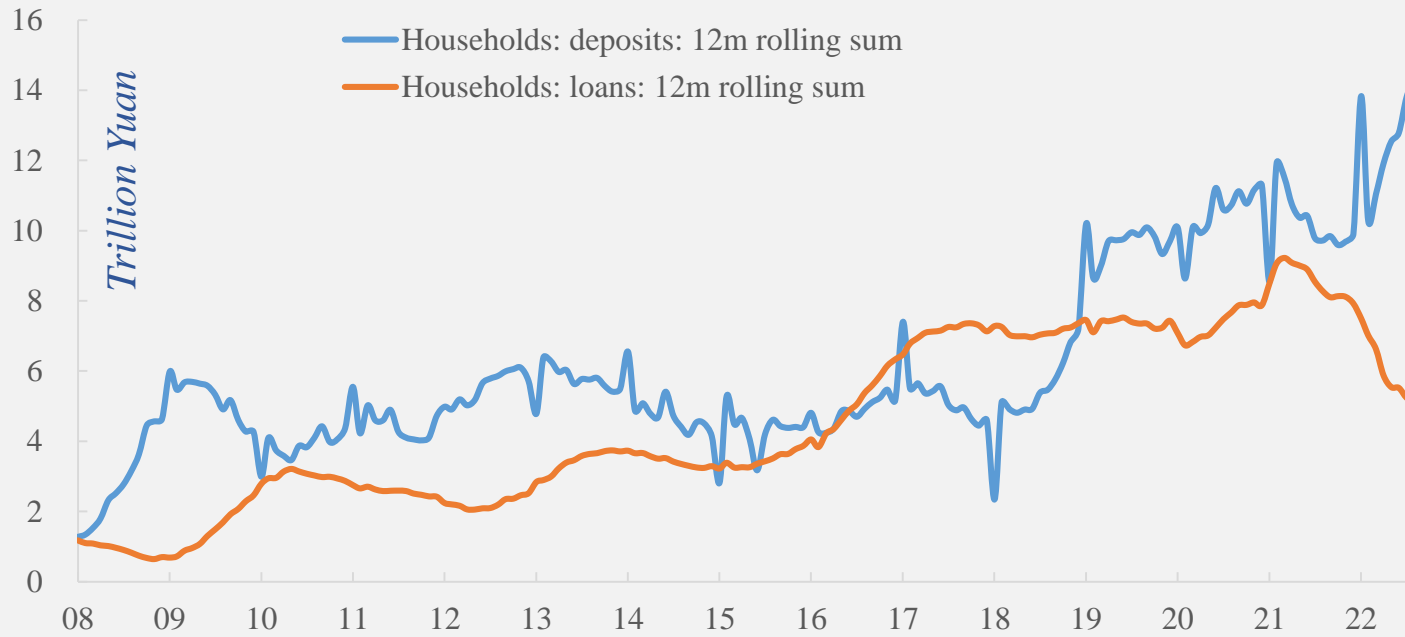
- Before 2020, exports is no longer the growth engine of China's economy for quite some time;
- China's Oct exports contracted by 0.3% yoy, which signals the end the of post-pandemic export boom;
- Meanwhile, the rebound in China's consumption growth strikes a stark contrast with falling export.



The underlying power of China's economy: **Household Savings**

Chinese Households' Balance Sheets:

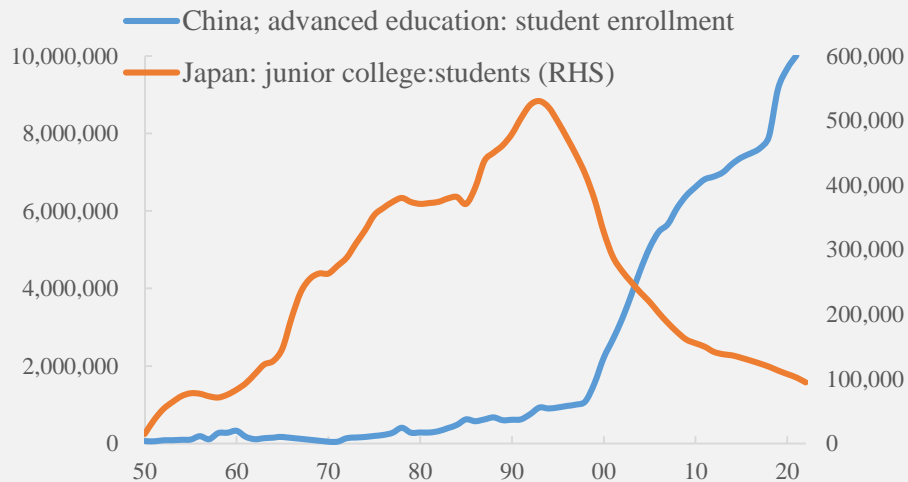
- Chinese households' saving rates have been increasing, which suggests improving balance sheet and growing momentum for future consumption.
- Since 2018, Chinese households' bank loans have been smaller than new deposits;
- Similar like the end of 2012, China's overall economy now is dominated by pessimistic expectations, uncertain global environments, and elevated inflation readings.



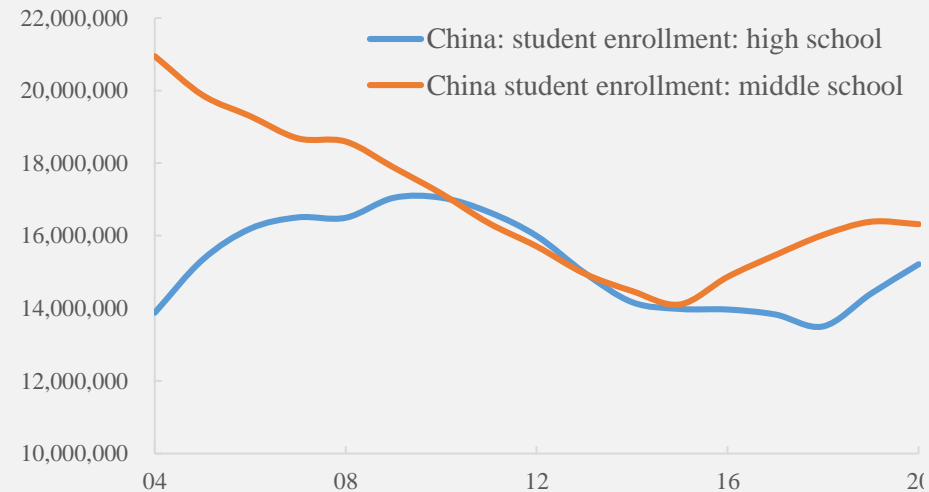
The underlying power of China's economy: **Human Resource**

- **Japanese Labor Force:** With an aging population, Japan's economic growth declined because of disappearing demographic dividend.
- **Chinese Labor Force:** While China is still not peaking in terms of high-quality labor force.
 - According to our estimation, China's student enrollments will start to decline in 2026, given the number of students currently registered in China's middle and high schools.
 - That means the peak of college students will come in 2028, with the highest number of student graduates in 2030.

China versus Japan



China Mid-and-High School Students



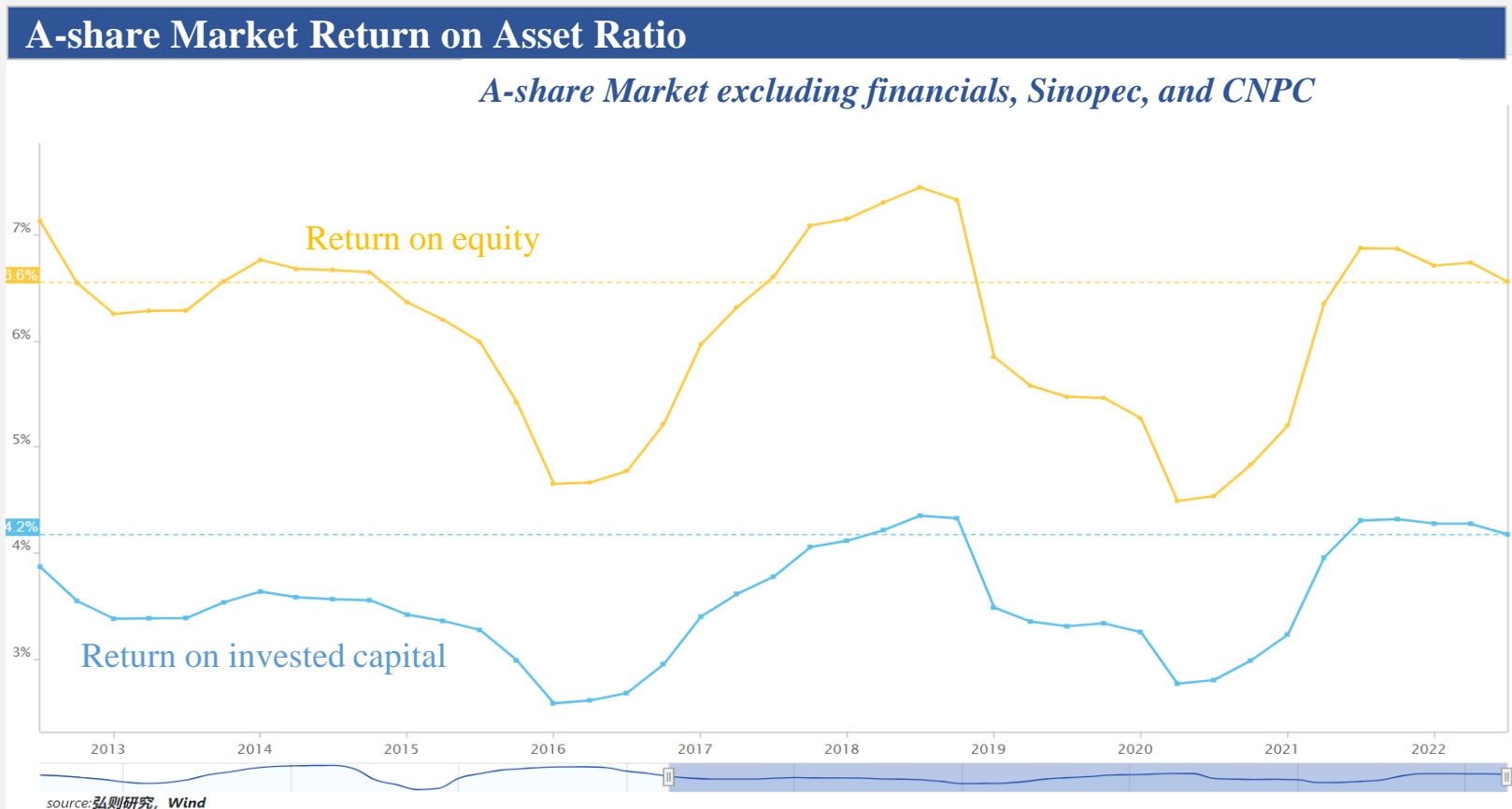
The underlying power of China's economy: **Manufacturing Hub**

- **World Factory:** Despite headwinds, China's manufacturing position is on the rise in the global markets;
- **Japan's road:** While in Japan's case, the country's foreign trade shows signs of peaking from 1987. Since then, the share of Japan's trade surplus as % of exports declined from 40% to 20% in late 1990s;
- **China's Resilience:** Moving forward, we see China's export growth to continuously slow down with falling global demand. However, the share of China's trade surplus as % of total exports will remain around 20% at the same time. That points to a limited impact on fund flows.



The underlying power of China's economy: **Manufacturing Hub**

- China's industrial capacity is still in the expanding stage, because industrial investments can still bring in positive returns.





02

Growth Challenge Now: property slowdown & exit of Covid-Zero policy

Policy Snapshot: From the 20th CCP to Dec Economic Work Conference

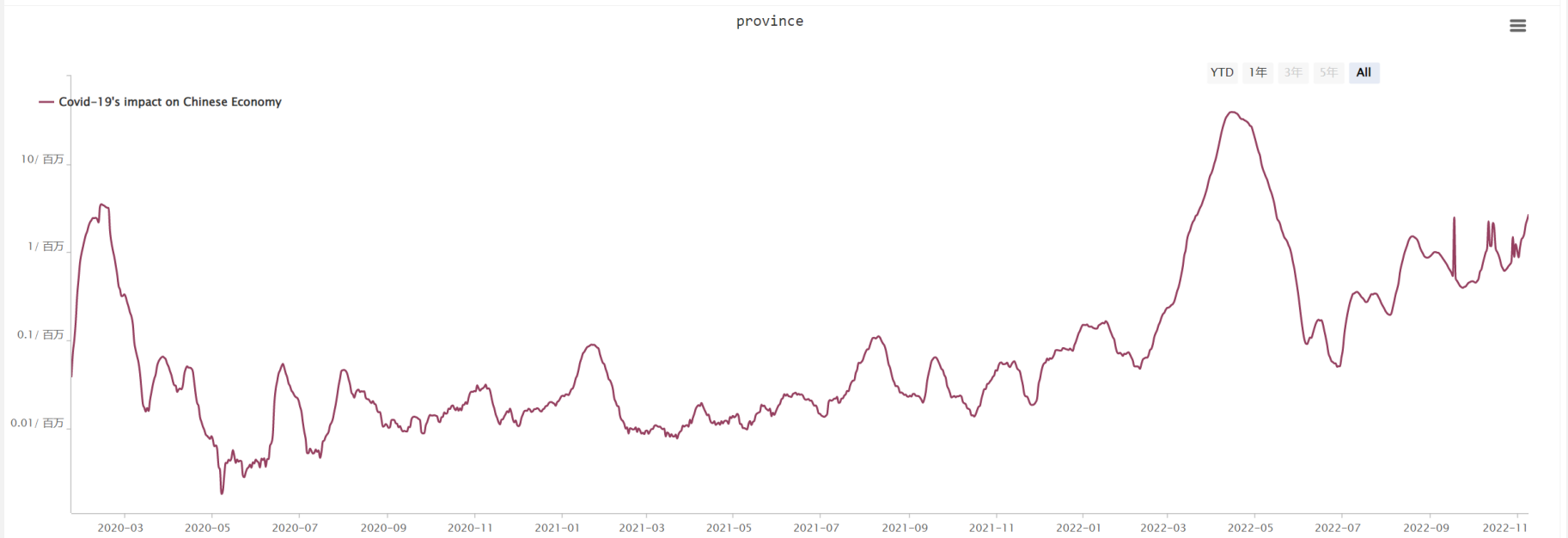
- **Key Takeaways from the 20th CCP Congress Meeting**
 - Short-term concerns are dispelled as the government reiterates the importance of development;
 - No further tightening in Official narratives on Covid controls, property woe, tech and private companies;
 - Longer-term prospect of China's economic remain in the picture, as the coherence of the new leadership signals well for reform, and it can help to realize the country's long-term goals (2035 growth target: common prosperity, and double circulation).

- **Key points to watch in the upcoming December Economic Work Conference:**
 - Economic Growth Target;
 - Monetary and fiscal Policy;
 - Government attitudes on the property slowdown and improper administrative behavior in Covid control measures.

Covid Control ——the Two-Blade Sword

- Surging Covid-19 Infections have brought concerns on economic growth.
- The government efforts on property recovery was dented by restrictive measures from virus controls.
- Based on the experience from the U.S., German and Vietnam, restrict virus control helps maintain stable supply chain while loosen covid policy helps service and consumption recovery.

Covid-19's Impact on Chinese Economy



China's Property Sector Slowdown

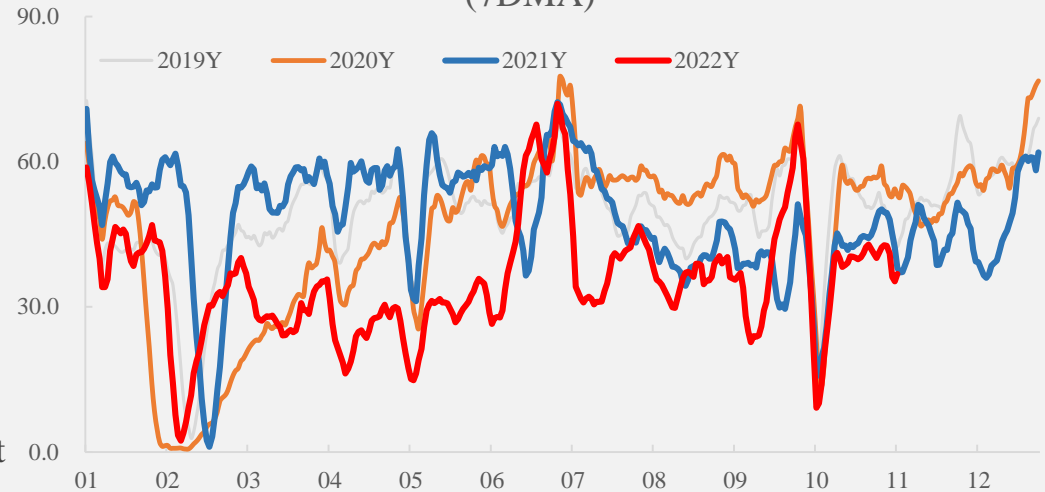
Modest Demand Recovery:

- Although China sticks to the housing-is-for-living policy, the government has rolled out a series of policies to help China's home sales;
- China's housing market has shown signs of improvements as the market confidence is recovering gradually with time.

Sharper Supply Contraction:

- Without government bailouts, the government property policy is focused to protect homebuyers and to secure housing delivery instead of saving individual firms;
- With tight controls on developers' funding, to have healthy cash flows has become the priority of property companies.
- As a result of cooling investments in the land market, China's property sector will see a sharp drop on the supply in 2023.

Home Sale Seasonality: 30 Large-and-Middle Cities (7DMA)



Developer Land Investments and New Starts



China Reopening Observations

- **Marginal Changes in Near Term (3 months):**
 - Reducing mandatory hotel quarantine for inbound travelers & adding more international flights;
 - Stop tracking people with indirect virus contact due to low infection ratio;
 - Scrapping isolation requirement for key diplomatic figures.
- **Potential Development in the Future (3-6 months):**
 - Self-imposed home isolation for people with close contact and reducing the isolation time;
 - Using antigen detection test to replace the PCR test (more efficient but less accurate);
 - Increasing vaccination rates with more vaccine options: nasal-spray vaccines have been approved.

China Reopening Observations

- **Rebalance of virus controls:** After three years with the pandemic, the cost of virus controls is becoming larger than the benefit.
- **Changing Dynamics are on the way:**
 - To start charging fees for PCR tests in some provinces due to financial pressure;
 - PCR test results are no longer required in some regions for train station and airports.
 - Official mouthpiece began to soften on virus impact on people's health.

Chinese guidelines for Covid Prevention & Controls:

- Close contact: 7 day isolation +3 day home observation (14+7, previously)
- Inbound quarantine: 7+3 days; PRC test from nasal to mouth swab
- High and low risk region management

Key areas to follow in the future;

- Vaccines and booster for elder citizens;
- Medical preparation;
- New Covid prevention and control guideline (Edition 10)



Key events going on:

- Foreign political leaders coming to China;
- Beijing Marathon Returns After 2-year virus disruption (2022/11/06);
- Shanghai CIIE (2022/11/05);
- Shanghai Marathon to kick off on Nov 27th 2022

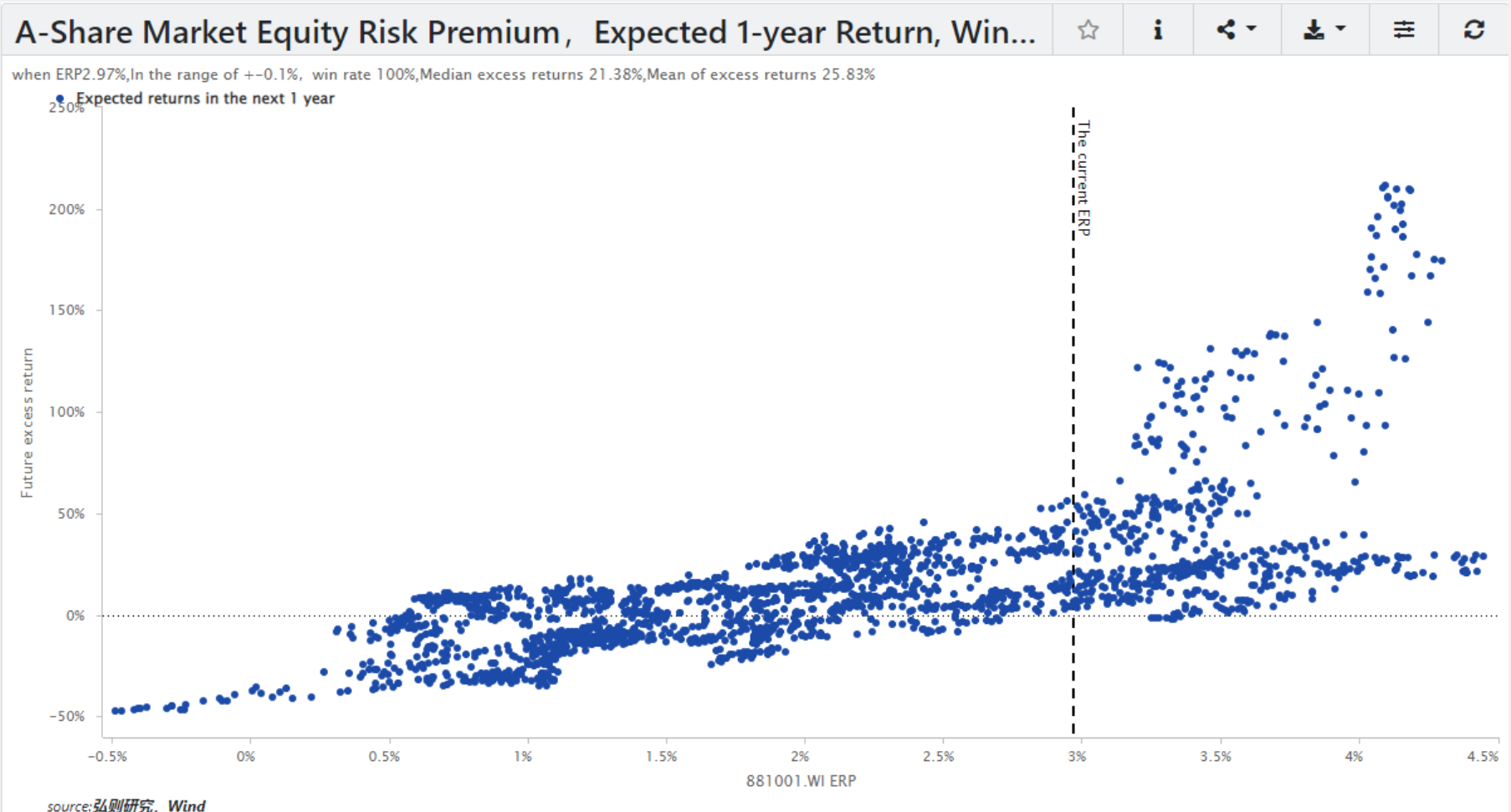


03

A-Share Strategy: The New Trends and Old Cycles

100% Win Rate Based on Valuation

- Based on current A-share equity risk premium, probability of positive return for 1 year holding period is 100% .



Market Sentiment is Bottoming out Since Mid-Oct 2022

- Market sentiment is bottoming out. From Oct. 11th, the market trading volume increased by 100% in one month.
- Based on a 100-day cycle, market momentum is likely to maintain through Dec.



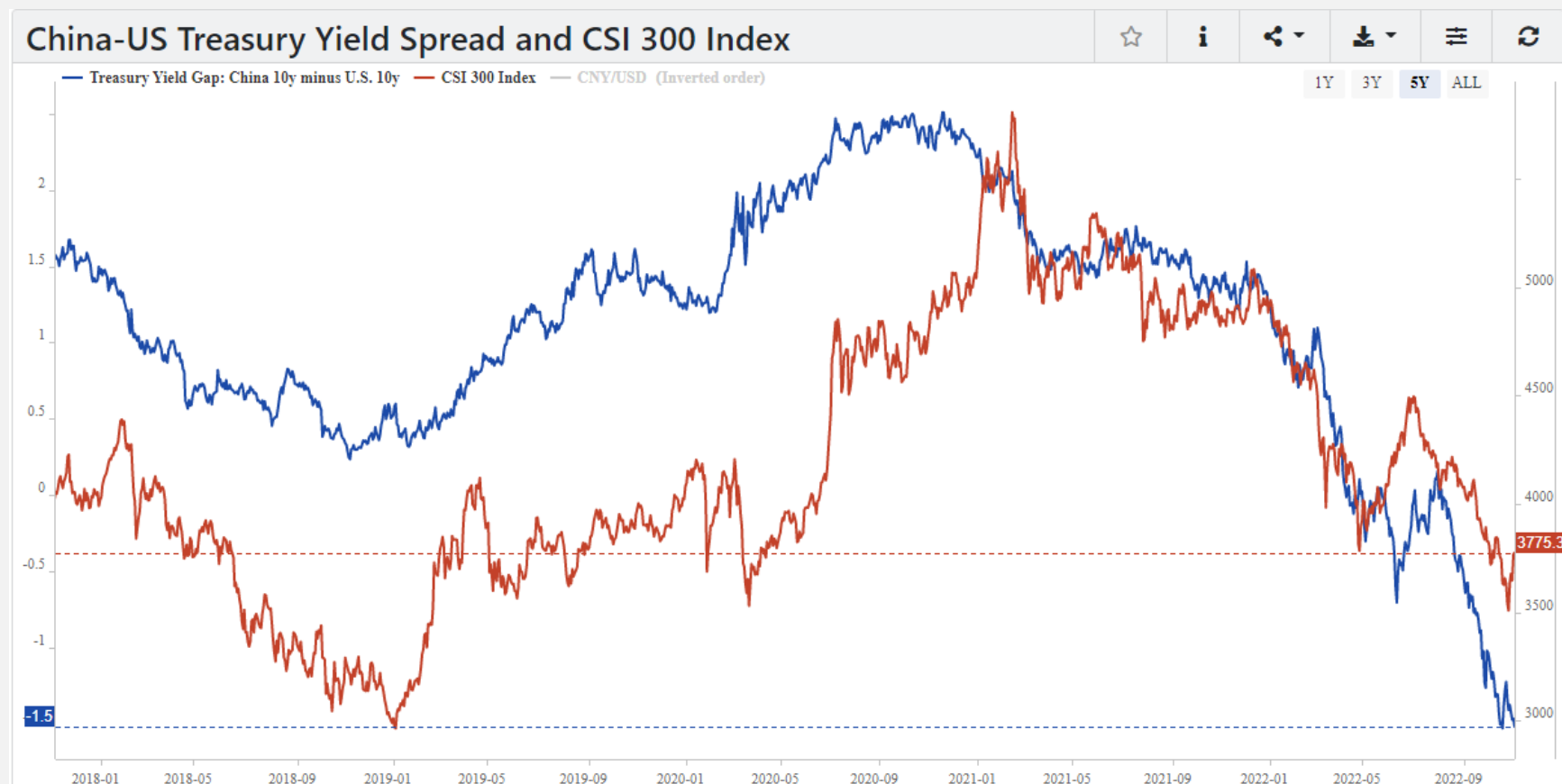
Long-Term Trend still Exists

- Even through the economic growth rate is decreasing, the market cap to GDP ratio is around 13%. The long term trend still exists while M2 grows at 10% annually.



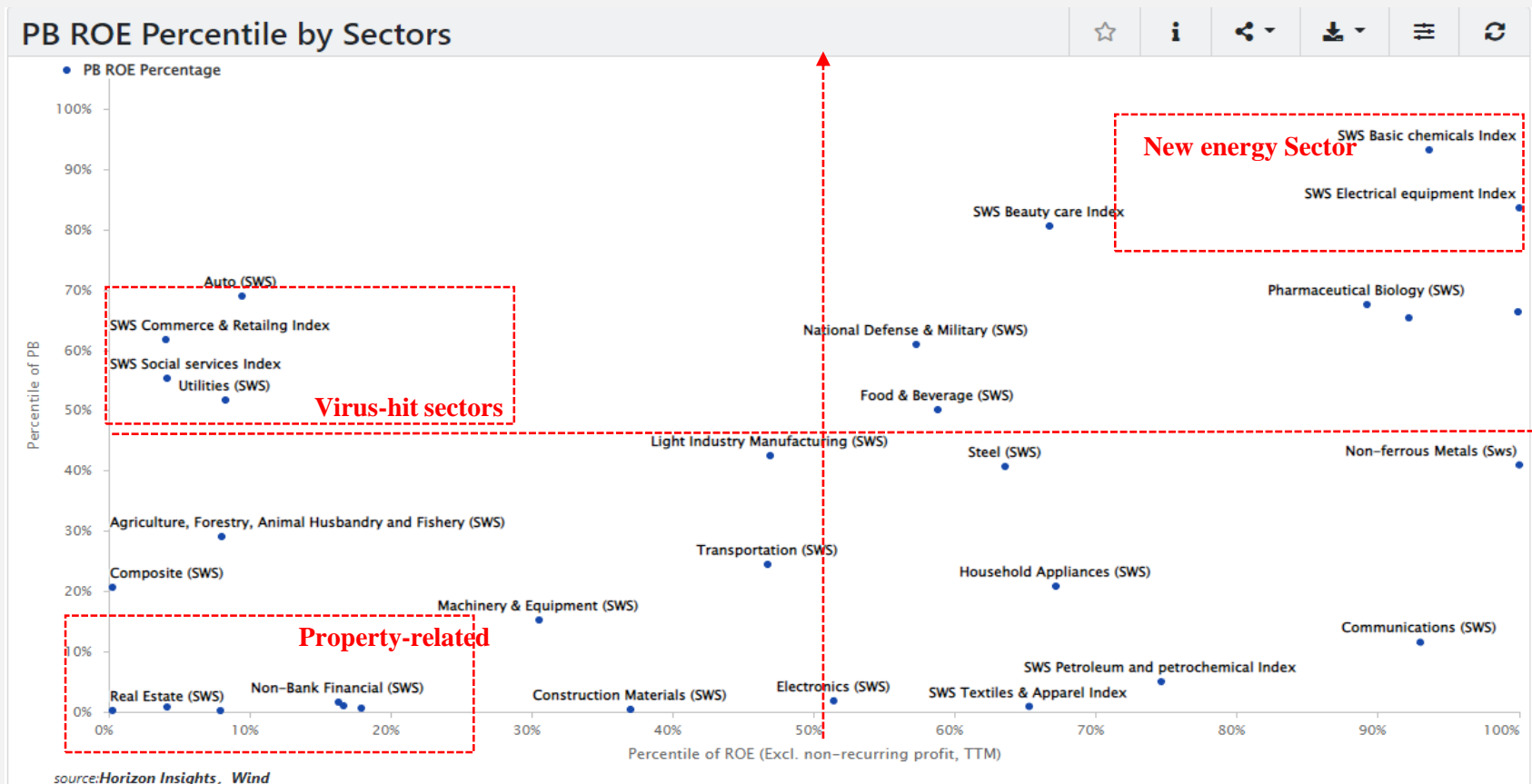
How the A-Share Market Reacts to Global Monetary Tightening?

- The interest rate spread between China and the U.S. has strong impact on the A-share market and RMB.
- However, we expect the spread to turn around in 2023 due to the decrease in commodity prices and the rebound for China's economy.



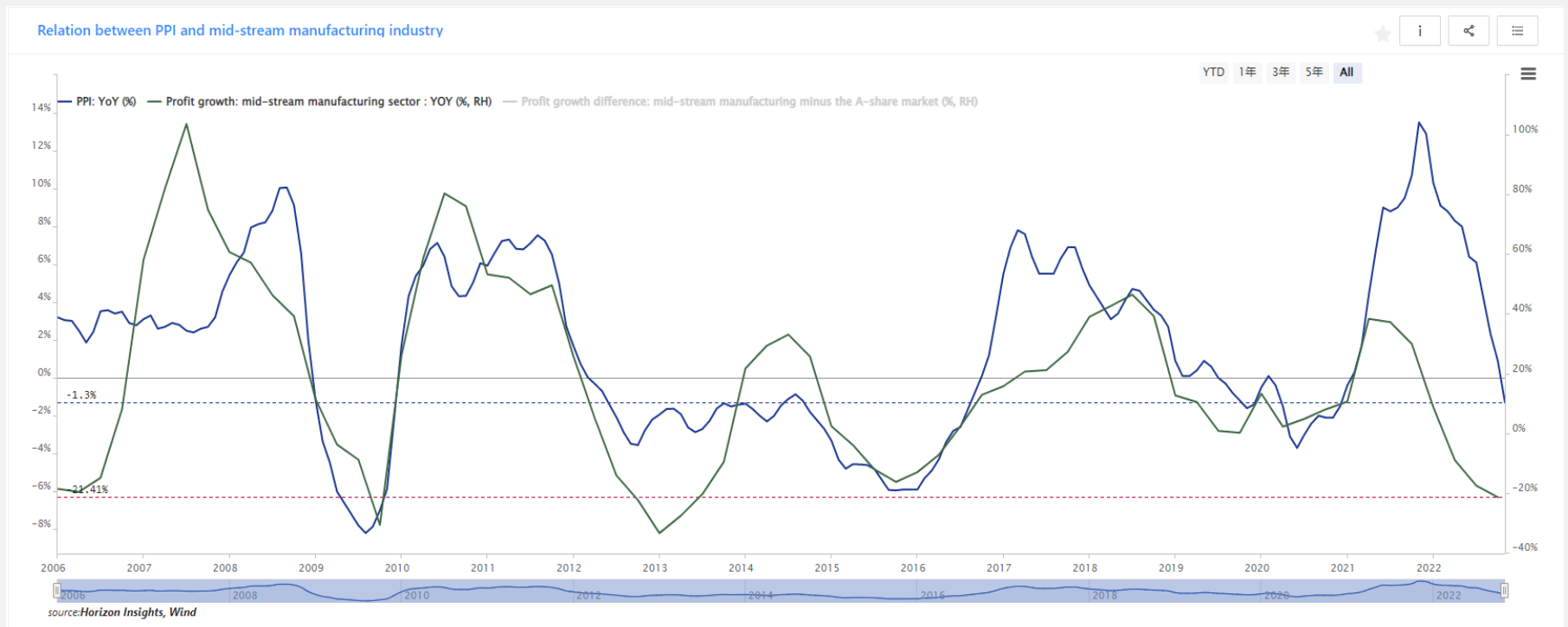
Sector Selection: New Energy v.s. Old Economy

- **Valuation Recovery Opportunity in Q4:** Property-related sector with depressed valuation multiples
- **Investment Lead in 2023:** Pro-growth beneficiary sectors
- New growth engine: capacity expansion + sustainable profit margin



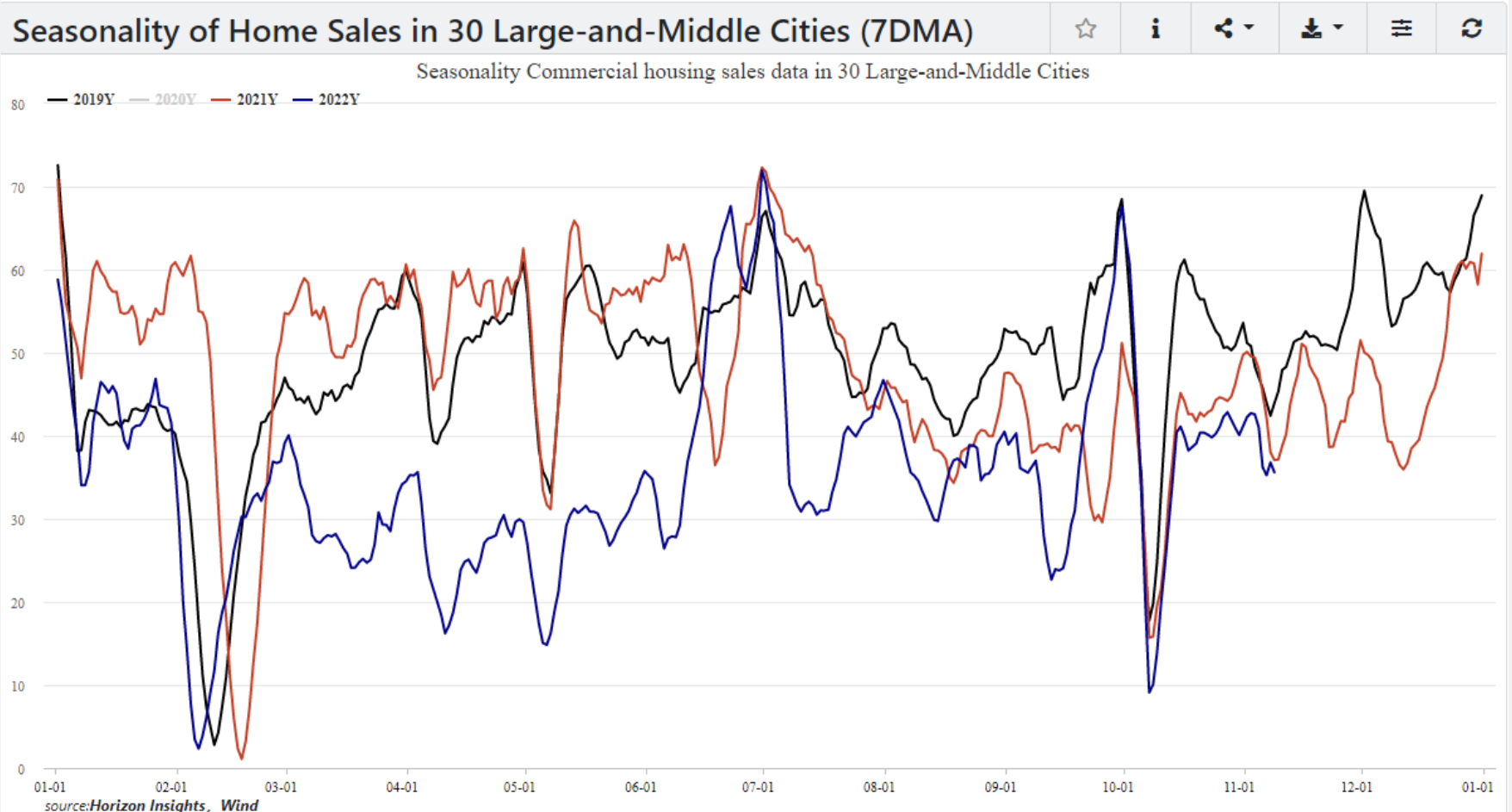
Sector Selection——Downstream v.s. Midstream

- With the decrease of PPI, profits for midstream and upper stream sectors face headwinds.



Sector Selection——Bottoming Out From the Worst

- Based on the high frequency data, China's housing industry has reached to a similar level as that of last year.



Summary

- China's economic growth rate will slow down, nevertheless, short term recovery for consumer sectors are more likely on the way. From exports to domestic consumption, China's growth engine swift will be key feature for both the economy and the market in 2023.
- The A-share market has gone through a strong sentiment momentum. Meanwhile the valuation is very attractive in both mid-and-long term.
- Looking into the future, we expect companies' profits to rebound in 23Q2, and downstream sectors will bottom out first.

Disclaimer

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Thanks!

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