

CCXI & CCXAP – Research & Commentary

Asset Allocations Shifts from Commodities to Stocks and Bonds amid Uneven Economic Recovery

Hong Kong, 23 July 2021 -- A report titled “2021H1 Review and H2 Outlook for Macro-economy and Asset Allocations - Asset Allocations Shift from Commodities to Bonds and Stocks amid Uneven Economic Recovery” has been recently published by the Research Institute of China Chengxin International Credit Rating Co. Ltd. (“CCXI Research Institute”). The report notes that China’s economy remains in an ongoing recovery, yet not back to normal, facing many risks and challenges. The report predicts that the annual economic growth will be about 8.6%, with a higher start to the year followed by a decline. The asset allocations will shift the focus onto stocks and bonds in H2 from commodities seen in H1. It is suggested to gradually reduce allocations to commodities.

The report notes that China’s economic recovery in H1 showed many uneven areas. There are three main areas of uneven recovery: First, uneven recovery of demand and supply. The production-demand gap narrowed, but demand recovery was still weaker than production comeback. Recovery on the producer side was uneven, with services significantly weaker than industries and growing disparities within the service sector. The demand recovery was also uneven, with real estate investment remaining the principal growth driver and consumer spending dented by the distorted income and consumption structures, while exports kept growing faster than domestic consumption. **Second, uneven price hikes.** The CPI-PPI spread widened reversely. PPI surged on rising prices of overseas raw materials, eroding profits of midstream and downstream manufacturers. **Third, uneven recovery between sectors and ownership types.** “Boom” industrial enterprises maintained a high level of production. There was a divergence in production between upstream and downstream industries. The rising commodity prices worsened the profitability imbalance between upstream and downstream industries. An uneven recovery was seen between state-owned and private sectors of the economy. Private-sector investments kept growing during the economic recovery from the coronavirus pandemic, compared with the past, the proportion of private sector investment is relatively low, and private industrial enterprises experienced slower profit growth than their state-owned counterparts.

The report notes that we still need to guard against risks and challenges facing the economy in the following five fields: Firstly, though the PPI hikes tend to abate, due attention should still be paid to profit erosion by imported inflation and cost rises fueled by the “emissions peak” and “carbon neutrality” drive. Secondly, local governments are still under the revenue and expenditure pressure, and some regions show marked debt risks. Thirdly, credit risks are quiet in the short term, but still under eruption pressure in the future, and particular attention should be paid to the resonance of local fiscal and financial risks. Fourthly, the micro economic entities show a highly uneven recovery, with downstream industries and private enterprises still under significant pressure to recover. Fifthly, there is a big structural employment pressure, with the employment pressure on the young population and migrant workers deserving great attention.

CCXI Research Institute believes that H2 will still see a complex economic situation with certainties and uncertainties interwoven as seen in H1. In terms of external environment, the global economy will remain on track for normalization as vaccines are distributed more broadly. However, major economies may change their quantitative easing policy in line with the global recovery, which may increase volatility in the global financial markets. Meanwhile, the major power game will also continue with a coexistence of intermittent easing and cooperation and continuous conflicts. As for domestic policies, the policies will remain stable and continuous after a gradual return to normal. Overall, the fiscal policy will remain proactive and the monetary policy will remain prudent. **The report predicts that the annual economic growth will be about 8.6%, with a higher start to the year followed by a decline.**

In terms of asset allocation, the report suggests refocusing on stocks and bonds in H2. Commodities recorded stronger growth on demand-supply mismatches and easy liquidity. The stock market was less attractive than the bond market due to the sharp correction of overvalued stocks in Q1 and easy interbank liquidity in Q2. The focus of asset allocations may shift from commodities to stocks and bonds in H2, so it is suggested to gradually reduce allocations to commodities. In terms of stocks, investors should focus more on the structure than on the broader index, and growth stocks may perform better. In terms of bonds, allocations may be relatively advisable when the 10-year CGB yield gets close to 3.2%, and a bigger weighting can be given to bonds if the economy comes under big downturn pressure.

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