Hamon Investment

# Quarterly Strategy

2Q 2023

The second quarter of 2023 saw developed markets continue to rally, while Asian markets had a mixed performance, with the Hong Kong/China markets and ASEAN region falling the most during period. The MSCI World Developed Market index gained 6.28% over the quarter, while the MSCI Asia ex-Japan index dropped 2.16%. The geopolitical backdrop remains challenging, as the war in Ukraine continued with no potential resolution in the near-term, and tensions are still heightened between the US and China.

Chinese equities were sharply lower in the second quarter, with the MSCI China net index down 9.71% as the economic rebound, following the country's reopening after the Covid-19 crisis, began to cool. Factory output in China also started to slow, due to lackluster consumer spending and weak demand for exports following interest rate rises in the US and Europe. The Hong Kong market also fell during the quarter, with the Hang Seng index down 7.11%, as a cooling of the Chinese economy also weakened sentiment towards Hong Kong stocks. Nevertheless, we remain positive towards the HK/China markets, as the Hong Kong market is trading at 9x forward P/E, far below its historical average, and we see good upside. A Chinese government official has also acknowledged the current state of the China economy and should announce some policies to stimulate the economy, which would boost the markets.

The crackdown on internet and internet-related companies seems to finally be at an end, as the fine on Ant Financial was settled in early July, closing the investigation on the company. Ant Financial may resume the listing process sooner than expected, as the company has begun buying back its shares, although the valuation is 40% lower than it was previously. Jack Ma, the co-founder of e-commerce giant Alibaba and an iconic figurehead for private companies, has also come back into the public spotlight and is said to be in charge of the Alibaba Group again. These measures should boost the market and internet-related stocks and signals that the Chinese central government will begin to shift focus to other sectors. With "common prosperity" being a strong theme of the central government, we believe they may turn their focus towards sectors such as the financial industry next, especially as there is an image of wealth and prosperity portrayed in this area.

We like consumer and tech names in China, such as Alibaba and Baidu, as consumer stocks were sold off heavily during the last six months. Alibaba will benefit from the removal of the overhang from the investigation into Ant Financial, as well as from their commitment for shareholder return by the reorganizing of the company into six entities. Alibaba also plans to spin off their Alibaba cloud business as an IPO and will give all its shares to existing shareholders as a special dividend, which will be a positive for the stock.

We believe that AI adoption will continue to be a growing area of focus, and we like Baidu, as it is a leading AI player in China, and has strong AI capability with the launch of its "Ernie" bot. The company also has a key advantage in proprietary training data from its search engine, and will also benefit from the recovery in its advertising business, as well as increasing AI adoption.

We do not believe the property market in China will have a v-shaped rebound in the near term, as the likelihood for a large stimulus in this area is not as high as previously expected. However, there are certain companies that will continue to do well and which we like, such as Yuexiu Property. Yuexiu leverages on its two major shareholders' backgrounds, namely the Guangzhou government and Guangzhou Metro, in land acquisition. This includes transit-oriented development (TOD) and urban redevelopment, which allows the company to acquire lands at a cheaper cost than its peers. It is expected the company will see top line growth of 20%, amid industry consolidation, and will reach RMB150bn in contract sales by the end of this year.

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# Quarterly Strategy (cont'd.)

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Japan was one of the best performing equity markets in the second quarter, with the Nikkei up 8.88%, as the yen weakened versus other major trading partners. Interest rates also remained low in Japan and the Bank of Japan maintained its yield curve control policy to anchor government bond yields, while interest rates rose higher in most other countries. This weakness in the yen helped support Japanese stocks, many of which earn a significant proportion of their profits abroad. We are positive towards the market as inflation is rising after years of deflation, retail sales are up, and consumer confidence is improving after seeing some of the largest pay rises in the past 30 years.

The US market performed well, with the S&P 500 and NASDAQ up 8.30% and 12.81% respectively over the quarter. However, the gains were driven almost entirely by the largest growth stocks, i.e. "mega-cap tech" stocks, which are disproportionately found in the US, with the rest of the market delivering much more muted returns so far this year. We remain cautious towards the market, and would only add selectively on a stock by stock basis.

Global semiconductors and hardware tech will also benefit from increasing adoption of AI and we continue to like the DRAM memory and semiconductor industry, especially Samsung and Micron. The market has been trading DRAM stocks as a cyclical play, and the this segment has been heavily discounted compared to the non-DRAM segment. While the companies are at the bottom of the cycle currently and may need some time to recover, we believe there will be ample room for stocks to be re-rated, especially as AI-related adoption and usage picks up, and look on this opportunity as a longer term play.

Government bond yields were on the rise again, although there was some divergence. With the exception of the BoJ, all major central banks kept raising interest rates over the quarter. However, the US Fed was the first to pause rate hiking in June, leaving rates at 5% to 5.25% after more than a year of consecutive rate increases. As the chance of further rate hikes in Q3 by the US fed is very likely, alongside risks of a recession in the coming year, we will look for an opportunity to add longer duration bonds in next two quarters.




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