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China Equity Strategy | Asia Pacific

Our Thoughts on Central Huijin Buying A-Shares

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We expect positive near-term market reaction. Long-term impact could be mixed, as suggested by historical evidence. Concerted rollout of policy support, upbeat growth/budget outlook, and geopolitical stabilization is key. We provide key events to monitor to identify sustainable market turning point.

What happened: China Central Huijin Investment Ltd. increased its A-share holdings in the four Chinese state-owned banks (ICBC, CCB, ABC and BOC) on Oct 11, 2023. It is also announced that Huijin will continue its purchase of more shares of these banks in the secondary market in the next six months.

Why and why now: We believe that this action is intended to send further signals to the market that the policymakers would like to step up their efforts to try to stabilize the equity market, particularly the A-share market. Earlier attempts in late August (including lowering the stamp duty, and lowering the minimum margin ratio for margin financing) had not resulted in a sustained effect – Shanghai Composite rose 3.7% between Aug 28 and Sep 4, from 3,064 to 3,177, only to see a steady retreat of 3.1%, down to 3,079 as of Oct 11, 2023. We have written in detail on these measures please see here. **The urgency at the current point, in our view, is likely related to two latest developments:**

1. Significant foreign outflow from the A-share market through the Northbound channel. The latest round of outflow started in July and had accelerated since August 7. Total cumulative net outflow has reached US$19.1bn, the largest in Stock Connect history since 2014, and the second-largest if counted by average daily outflow during the period.

2. Shanghai Composite Index is just ~6.4% away from last year's cycle trough (2,893 on Oct 31 2022 vs. 3,079 as of Oct 11 2023, nearly a year ago right before Covid reopening), with little concrete signs in sight on the fundamental side to turn the sentiment around (Exhibit 7 , Exhibit 6).

Market implications – near-term positive while longer-term impact uncertain. We expect positive reaction from the market in the near term – Shanghai Composite opened 0.7% higher today (Oct 12), so far trading at 0.9% higher vs. the previous day's close. That said, whether the market could be effectively stabilized or reversed into a upward trend is not, in our view, solely dependent on such state purchase actions, particularly if it is as one-off as in the past. Historical data shows that on average the market (proxied by Shanghai Composite) would have corrected by a further ~17% on average before hitting the cycle low. (Exhibit 4)

(*continued in next section*)

(continued)

What matters from here: Concerted effort to improve fundamentals + geopolitical stabilization + ideally more consistent/systematic institutional purchase commitment would be key. We suggest monitor the following developments which if being rolled out in a continuous fashion, would help stabilize the market, in combination with the policymakers' effort to boost market sentiment. At least 3 or 4 out of the list below would need to take pace to ensure a more sustained market recovery, in our view.

- **Oct 2023:** additional ~RMB1trn LGSB funding to temporarily support the economy;
- **Oct – Nov 2023:** Third Plenum on structural reform agenda;
- **Nov 15-17, 2023:** President Xi attending APEC Summit in San Francisco, with a potential 1-on-1 meeting with President Biden;
- **Oct - Dec 2023:** Further stabilization of macro data pack (inflation, IP, PMI etc) which could support earnings revisions bottoming out;
- **Oct - Dec 2023:** Stabilization of the housing market downfall and the offshore high yield bond market (i.e., Chinese developer bonds);
- **Oct - Dec 2023:** Further progress on local government debt swaps;
- **Dec 2023:** Central Economic Work Conference - 2024 GDP growth outlook and policy stance on economic growth in 2024;
- **Mar 2024:** National People's Congress - potentially higher than expected GDP target (4.5% or above), fiscal deficit widening, public project acceleration (i.e. urban village rebuilding)

It is also worth highlighting that Central Huijin's purchase actions should not be mistaken with Bank of Japan's long-term commitment to buying Japanese stocks through the large-scale index-linked exchange-traded fund (ETF) purchase program. This program was first introduced in 2014, and has improved the liquidity situation in Japan stock market. Huijin's actions so far has no indication to be a recurring event on a long-term basis, based on the statements released so far and the past episodes.

More sustained commitment of institutional purchase, through sovereign wealth fund, and/or pension/retirement funds, as well as insurance funds could be helpful, if happens. As part of the latest market stabilization measures, NAFR (National Administration of Financial Regulation) released a new regulatory file on Sep 10, 2023 aiming at optimizing insurers' solvency ratio standards. This could potentially support increased allocation to equities by insurance companies given lower solvency ratio and lower risk factors assigned to equities. That said it is very early stage and the long-term sustained implications on allocation remains to be monitored.

Summary of past Huijin purchases and market response

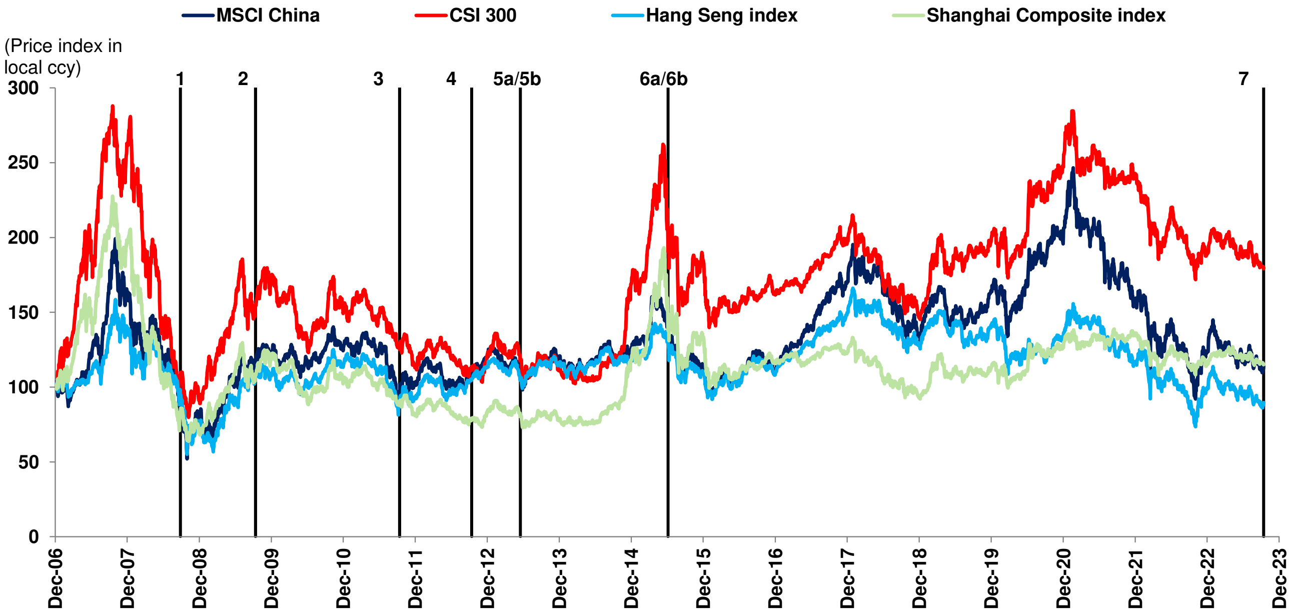
Historical evidence shows that market tends to react positively to Huijin purchase announcements, at least in the short term, especially for the onshore market: Our analysis is based on historical market data during 2007-23 for CSI 300, Shanghai Composite index, MSCI China and Hang Seng index. On average, four indices delivered 0.6%, 0.6%, 0.5% and 0.4% positive performance respectively one day after the announcement (Exhibit 3). Such positive momentum has tended to last through at least the first week. In one week, onshore indices have tended to sustain such positive response, with CSI 300 and Shanghai Composite index delivering on average 2.7% and 2.3% index performance, respectively. **However, such positive momentum would rarely last for one month or longer; the market performance could be described as "mixed" at best:** On average, four indices delivered negative performance of 0.4%, 0.2%, 0.4% and 0.5%, respectively by the end of one month post purchase actions, and even worse performance on a three-month basis. Six months post purchase actions, we see on average positive returns for three indices (CSI300, Shanghai Composite and MSCI China). However this in our view could be hardly credited to the Huijin purchases any more.

Exhibit 1: Details of Huijin purchase of A-share stocks since 2008

	Date	Details of Huijin Purchase
1	**9/23/2008**	Huijin announced that it would purchase shares of Industrial and Commercial Bank of China (ICBC), Bank of China (BOC), and China Construction Bank (CCB) shares, with a one-year commitment period.
2	**10/11/2009**	ICBC, BOC and CCB announced separately that they have received notifications from shareholder Huijin to increase its shareholdings of A shares through Shanghai Stock Exchange trading system.
3	**10/10/2011**	In order to support steady operation and development of key state-owned financial institutions and stablize stock prices of state-owned commercial banks, Huijin will purchased shares all four major banks on secondary market.
4	**10/10/2012**	Huijin announced that it would purchase shares of all four major banks shares, with a commitment period of 6 months.
5a	**6/14/2013**	Huijin spent RMB 360mn to increase its holdings in four major banks. In addition, it also increased its holdings of 22mn shares of Everbright Bank and 2mn shares of New China Insurance.
5b	**6/20/2013**	Huijin made its first public announcement to make purchase of ETFs.
6a	**7/5/2015**	Huijin stepped in to protect the market, with a net subscription of RMB 39.5bn in four major blue-chip weighted ETFs in four days.
6b	**8/18/2015**	Huijin acquired approx. 4.5bn shares in total from all four major banks through share transfer agreement, costing nearly RMB 20bn.
7	**10/11/2023**	Huijin obtained additional shareholding of four major state-owned banks totalled more than 100mn shares, with plan to further increase its secondary market shareholding in the next six months.

Source: HKEX, company website, Reuters, Morgan Stanley Research.

Exhibit 2: Chinese equity indices' performance in reaction to Huijin purchase announcements since 2007 – Market had usually tended to respond positively in the short term



Source: SSE, SZSE, CSRC, Datastream, Morgan Stanley Research. Data as of October 11, 2023. Refer to Exhibit 1 for event details.

Exhibit 3: Chinese equity indices' reaction to Huijin's announcements on purchasing A-shares since 2007 – market tended to react positively in the short term, but such momentum does not seem to sustain further out

Huijin purchase annoucement date	Market performance post announcements (1-day)				Market performance post announcemetts (5-day)				Market performance post announcemetts (1-month)				Market performance post announcements (3-month)				Market performance post announcements (6-month)			
	CSI 300	Shanghai Composite Index	MSCI China	Hang Seng Index	CSI 300	Shanghai Composite Index	MSCI China	Hang Seng Index	CSI 300	Shanghai Composite Index	MSCI China	Hang Seng Index	CSI 300	Shanghai Composite Index	MSCI China	Hang Seng Index	CSI 300	Shanghai Composite Index	MSCI China	Hang Seng Index
9/23/2008	0.7%	0.7%	0.3%	0.5%	5.7%	4.2%	(5.5%)	(4.5%)	(11.4%)	(11.0%)	(22.5%)	(20.3%)	(6.1%)	(10.3%)	(14.4%)	(19.8%)	5.5%	(2.0%)	(25.8%)	(38.0%)
10/12/2009	1.5%	1.4%	1.1%	0.8%	5.6%	5.0%	4.8%	4.2%	10.9%	9.7%	6.0%	4.3%	12.2%	12.1%	5.6%	2.5%	6.6%	7.9%	3.6%	(0.3%)
10/10/2011	(0.2%)	0.2%	3.5%	2.4%	4.3%	4.1%	9.4%	6.6%	7.0%	7.0%	15.5%	11.1%	(8.3%)	(6.2%)	8.1%	4.1%	(0.1%)	0.2%	18.3%	16.7%
10/10/2012	(0.9%)	(0.8%)	1.3%	0.4%	(1.0%)	(0.7%)	3.2%	2.4%	(1.6%)	(0.7%)	7.6%	5.6%	8.6%	7.0%	15.6%	11.4%	11.2%	8.6%	8.3%	7.4%
6/14/2013	(0.5%)	(0.3%)	0.9%	1.2%	(4.1%)	(4.1%)	(4.1%)	(3.4%)	(5.9%)	(5.7%)	(0.2%)	1.5%	(2.4%)	(1.0%)	8.9%	7.9%	0.9%	2.7%	18.1%	13.9%
7/3/2015	2.9%	2.4%	(4.1%)	(3.2%)	5.7%	5.2%	(5.2%)	(4.5%)	(1.8%)	(0.6%)	(8.6%)	(5.5%)	(16.8%)	(16.1%)	(20.4%)	(18.7%)	(3.0%)	(2.9%)	(18.5%)	(16.5%)
Average return of Huijin purchase announcements:	**0.6%**	**0.6%**	**0.5%**	**0.4%**	**2.7%**	**2.3%**	**0.4%**	**0.1%**	**(0.4%)**	**(0.2%)**	**(0.4%)**	**(0.6%)**	**(2.1%)**	**(2.4%)**	**0.6%**	**(2.1%)**	**3.5%**	**2.4%**	**0.7%**	**(2.8%)**

Source: SSE, SZSE, CSRC, Datastream, Morgan Stanley Research. Data as of October 11, 2023.

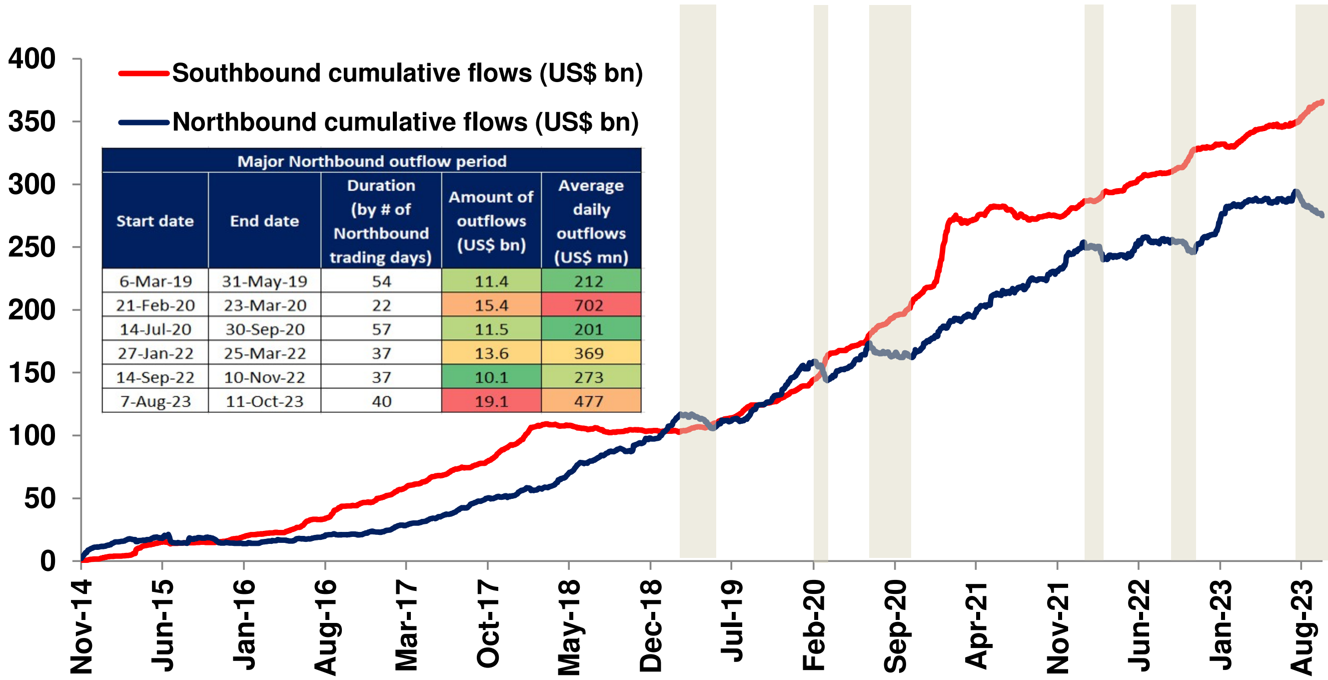
Exhibit 4: Summary of historical equity impact after Huijin purchase – The announcements by Huijin usually are not coincident with market trough

Huijin purchase annoucement date	Market trough dates	Shanghai Composite index performance between annoucements date and market trough dates	Time take to market trough (Calendar days)
9/23/2008	11/4/2008	(22.5%)	42
10/12/2009	7/5/2010	(18.3%)	266
10/10/2011	9/26/2012	(14.5%)	352
10/10/2012	6/27/2013	(8.0%)	260
6/14/2013	6/27/2013	(9.8%)	13
7/3/2015	1/28/2016	(28.0%)	209
Average return from Huijin purchase announcements dates to market trough dates:		**(16.9%)**	**190**

Source: Datastream, MSCI, Morgan Stanley Research. Data as of October 11, 2023.

Key charts and tables

Exhibit 5: Southbound and Northbound cumulative flows with major Northbound outflow periods – The recent round of continuous Northbound outflow is the most significant since Stock Connect inception by total amount of outflows



Major Northbound outflow period

Start date	End date	Duration (by # of Northbound trading days)	Amount of outflows (US$ bn)	Average daily outflows (US$ mn)
6-Mar-19	31-May-19	54	11.4	212
21-Feb-20	23-Mar-20	22	15.4	702
14-Jul-20	30-Sep-20	57	11.5	201
27-Jan-22	25-Mar-22	37	13.6	369
14-Sep-22	10-Nov-22	37	10.1	273
7-Aug-23	11-Oct-23	40	19.1	477

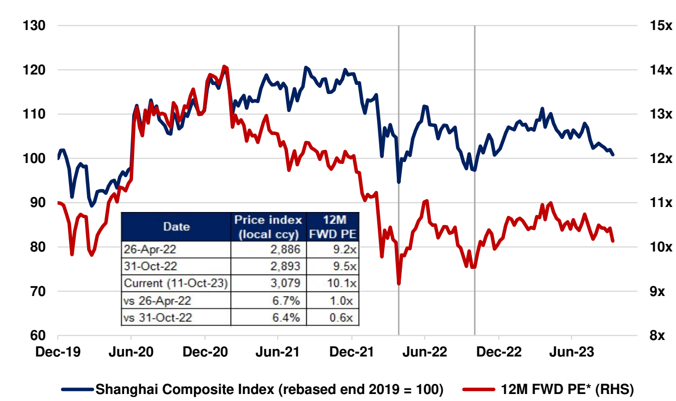
Source: CEIC, Morgan Stanley Research. Data as of October 11, 2023.

Exhibit 6: CSI 300 and 12m fwd P/E valuation - CSI 300 is trading just 5% (by price index) and 0.3x (by valuation) above market trough in end Oct 2022

Date	Price index (local ccy)	12M FWD PE
26-Apr-22	3,784	10.9x
31-Oct-22	3,509	10.4x
Current (11-Oct-23)	3,668	10.7x
vs 26-Apr-22	(3.1%)	(0.2x)
vs 31-Oct-22	4.5%	0.3x

Source: Datastream, Morgan Stanley Research. Weekly data as of October 10, 2023

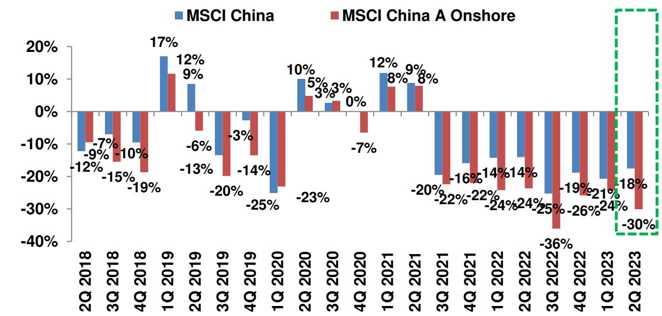
Exhibit 7: Shanghai Composite Index and its 12m fwd P/E valuation - The index is trading just 6% (by price index) and 0.6x (by valuation) above market trough in end Oct 2022



Date	Price index (local ccy)	12M FWD PE
26-Apr-22	2,886	9.2x
31-Oct-22	2,893	9.5x
Current (11-Oct-23)	3,079	10.1x
vs 26-Apr-22	6.7%	1.0x
vs 31-Oct-22	6.4%	0.6x

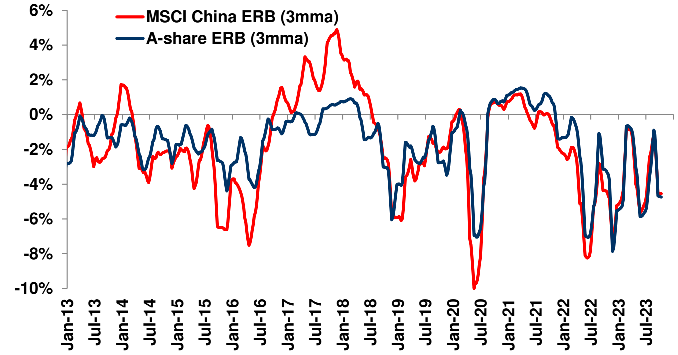
Source: Datastream, Morgan Stanley Research. Weekly data as of October 10, 2023. *Valuation for Shanghai A-share index is displayed due to data availability

Exhibit 8: History of Chinese equity market quarterly earnings surprises by number of companies - Chinese equities have missed consensus earnings for eight consecutive quarters



Source: MSCI, Bloomberg, RIMES, Factset, Morgan Stanley Research. Data as of September 14, 2023.

Exhibit 9: 12-month forward consensus earnings estimate revision breadth (ERB, 3mma) - Downward revision has reaccelerated since end of August



Source: MSCI, IBES, Rimes, Morgan Stanley Research. Weekly data as of October 10, 2023. Earnings Estimate Revision Breadth (ERB) = (number of upward revisions - number of downward revisions) / total number of consensus estimates

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Underweight/Sell	608	17%	68	10%	11%	225	15%
Total	3,634		652			1543	

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