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China Quantitative Strategy | Asia Pacific

Macro Webcast: Factor Implications for China From Japan's Deflation Era in the 1990s

The recent performance of Chinese equities shares many similarities with what happened in Japan in the 1990s. Valuation mean reversions and price reversal trades have dominated the alpha, while buy-and-hold opportunities became difficult to identify. We discuss details in this report.

Related Report: [Asia Quantitative Strategy: Biweekly Perspectives: Factor Implications for China From Japan's Deflation Era in the '90s \(14 Aug 2023\)](#)

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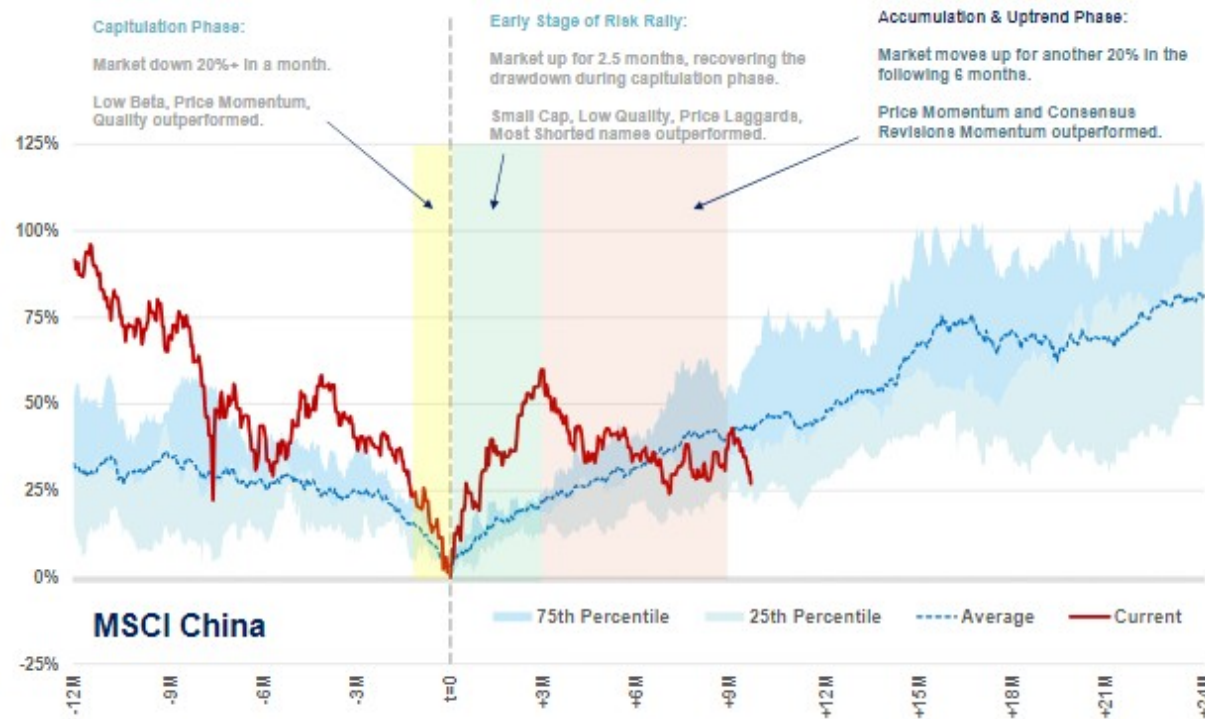
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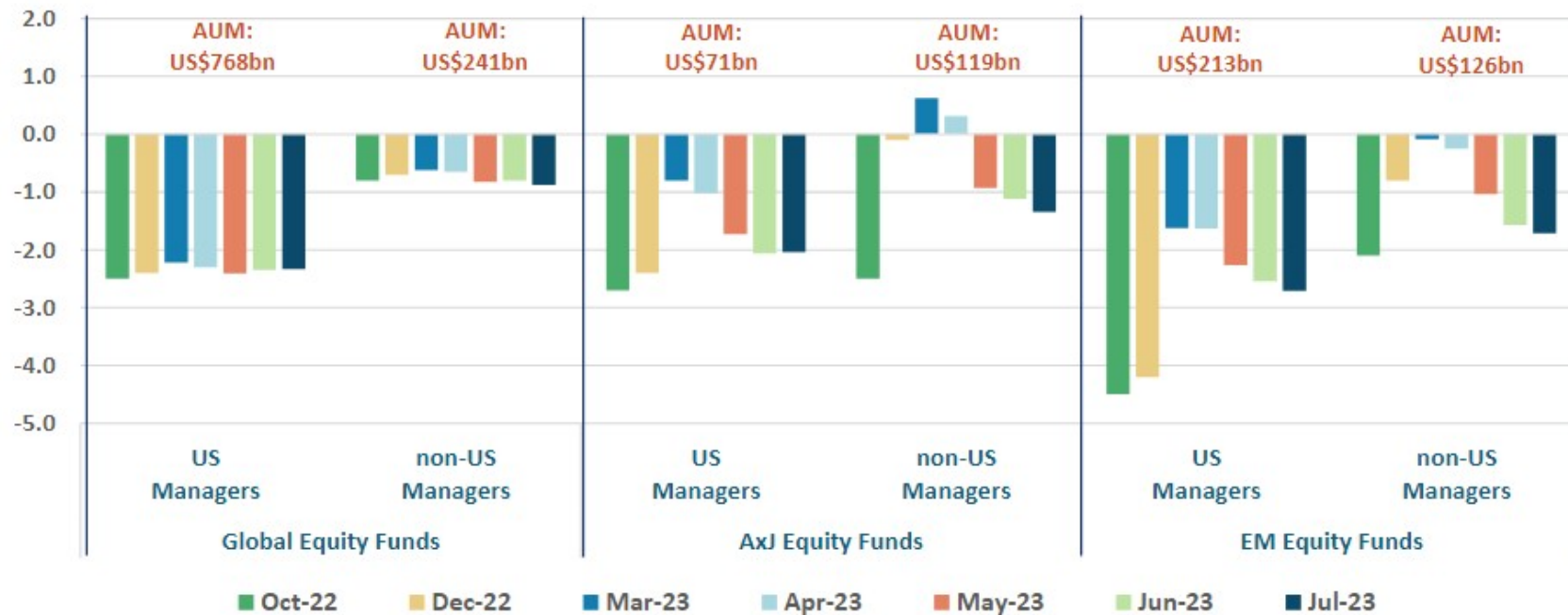
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Historical MSCI China Performance Before and After Market Trough



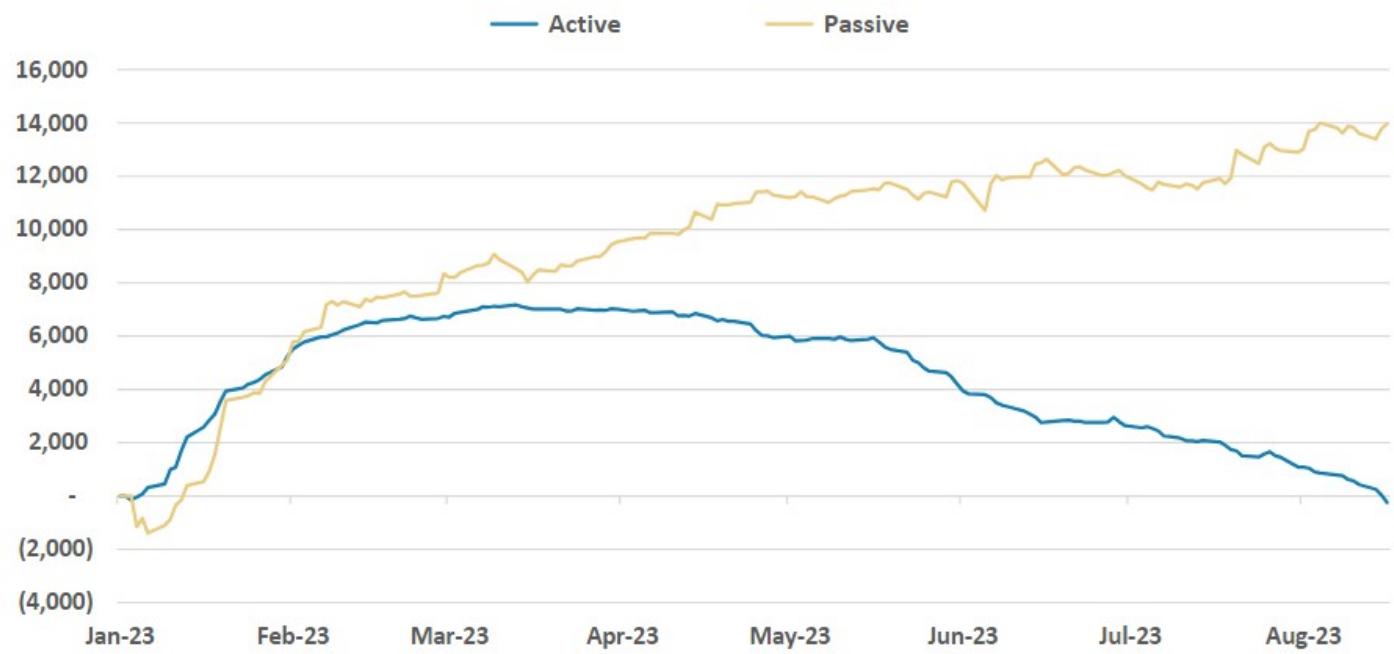
Source: FactSet, Bloomberg, MSCI, Morgan Stanley Research. Note: data coverage is from Jan 1995 to the latest, covering 10 market capitulation scenarios of MSCI China - Sep 10, 1998, Oct 3, 2001, Oct 10, 2002, May 17, 2004, Jun 13, 2006, Mar 2, 2009, Oct 4, 2011, Jan 21, 2016, Oct 29, 2018, Mar 23, 2020. The red line is MSCI China return in current cycle; we fit the timeline based on MS Asia Risk Sentiment Indicator and drawdown trajectory. Past performance is no guarantee of future results.

Active Weights of China/HK Equities by Regional Fund Category and Manager Domicile



Source: MorningStar, FactSet, EPFR, Morgan Stanley Research; notes: the fund universe of each category is formed by the largest 30 active mutual funds under MorningStar regional category. We exclude ESG funds, Income funds, and Systematic funds. All the covered funds are benchmarking to either MSCI or FTSE standard regional indices of All Country World, Asia ex Japan, or Emerging Markets.

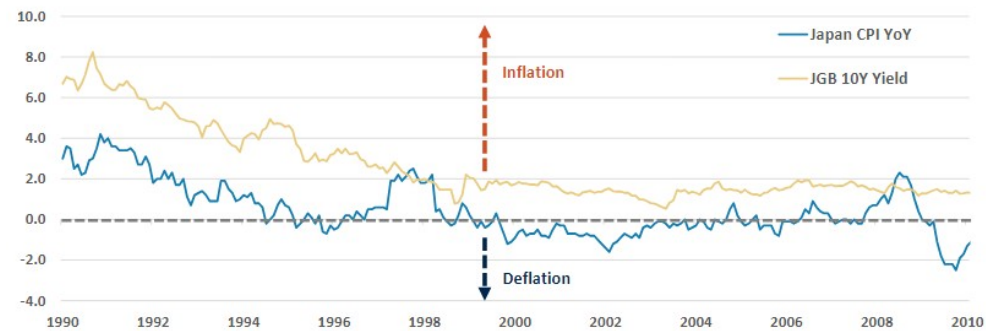
Cumulative Fund Flows to China Equities YTD –
Foreign Active Long-only Managers Have Fully Sold Down What They Bought in 1Q23



Source: MorningStar, FactSet, EPFR, Morgan Stanley Research

Inflation and Government Bond Yield Comparison

Japan between 1990 and 2010



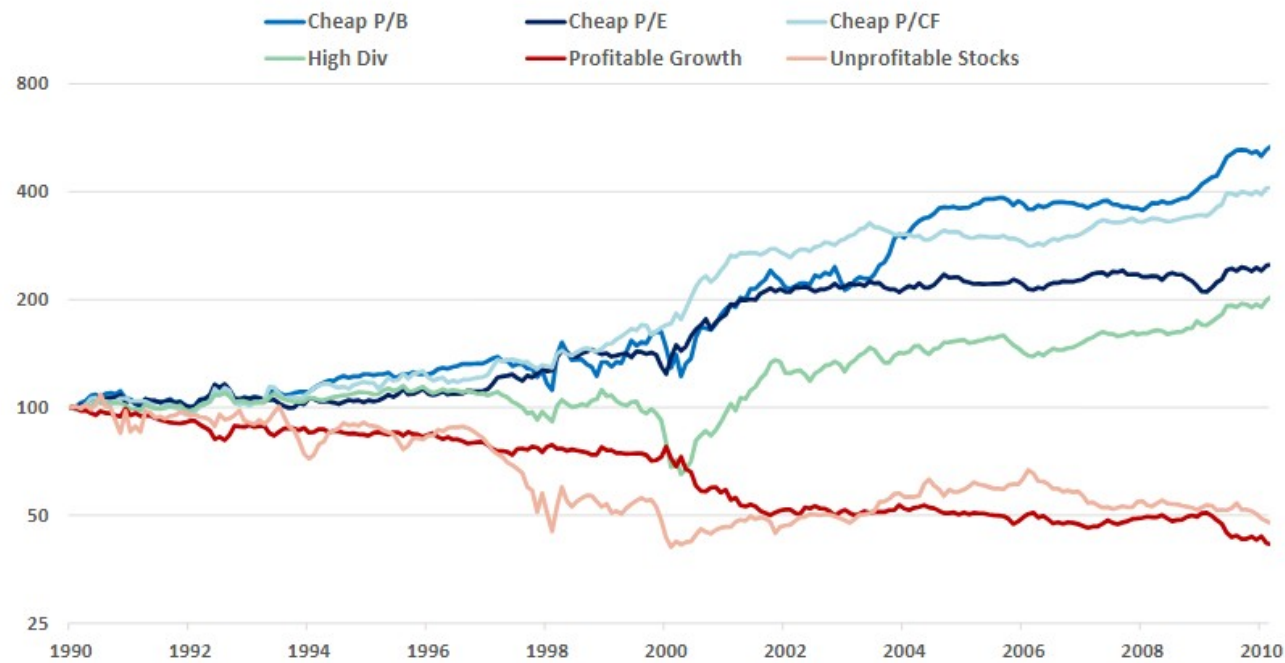
China over last 10 years



Source: Bloomberg, Morgan Stanley Research

Alpha Factors in Japan During 1990s

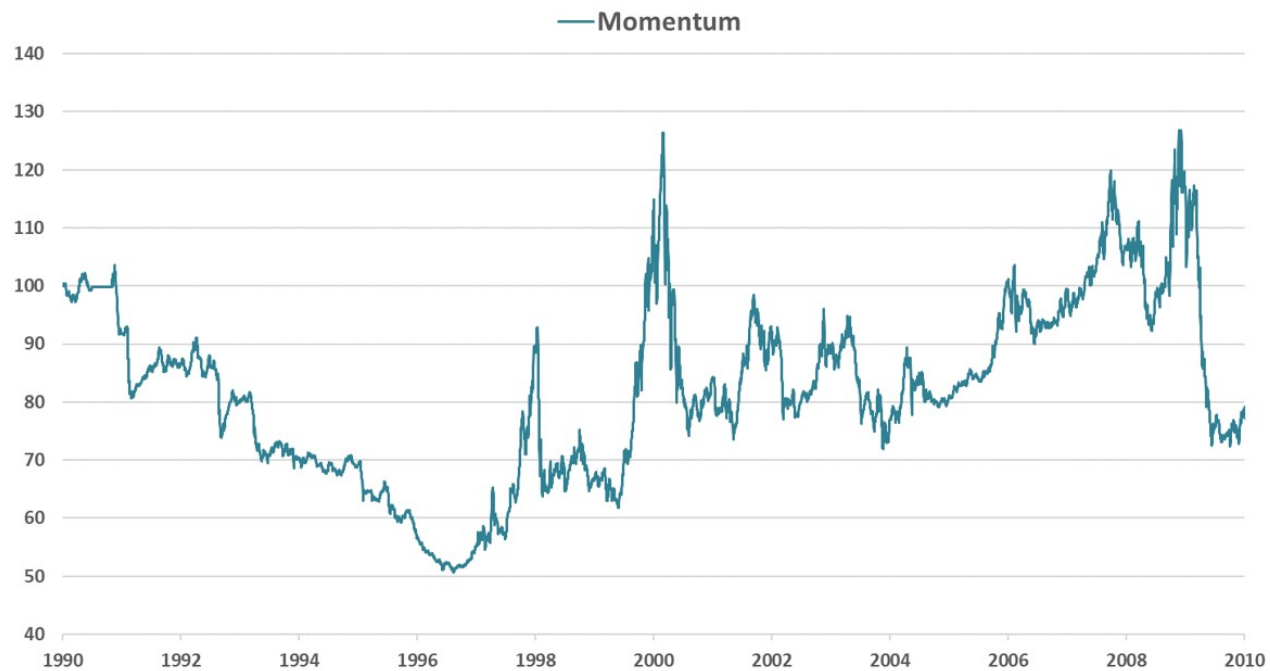
Takeaway (i) – Value Outperformed Growth



Source: FactSet, Morgan Stanley Research

Alpha Factors in Japan During 1990s

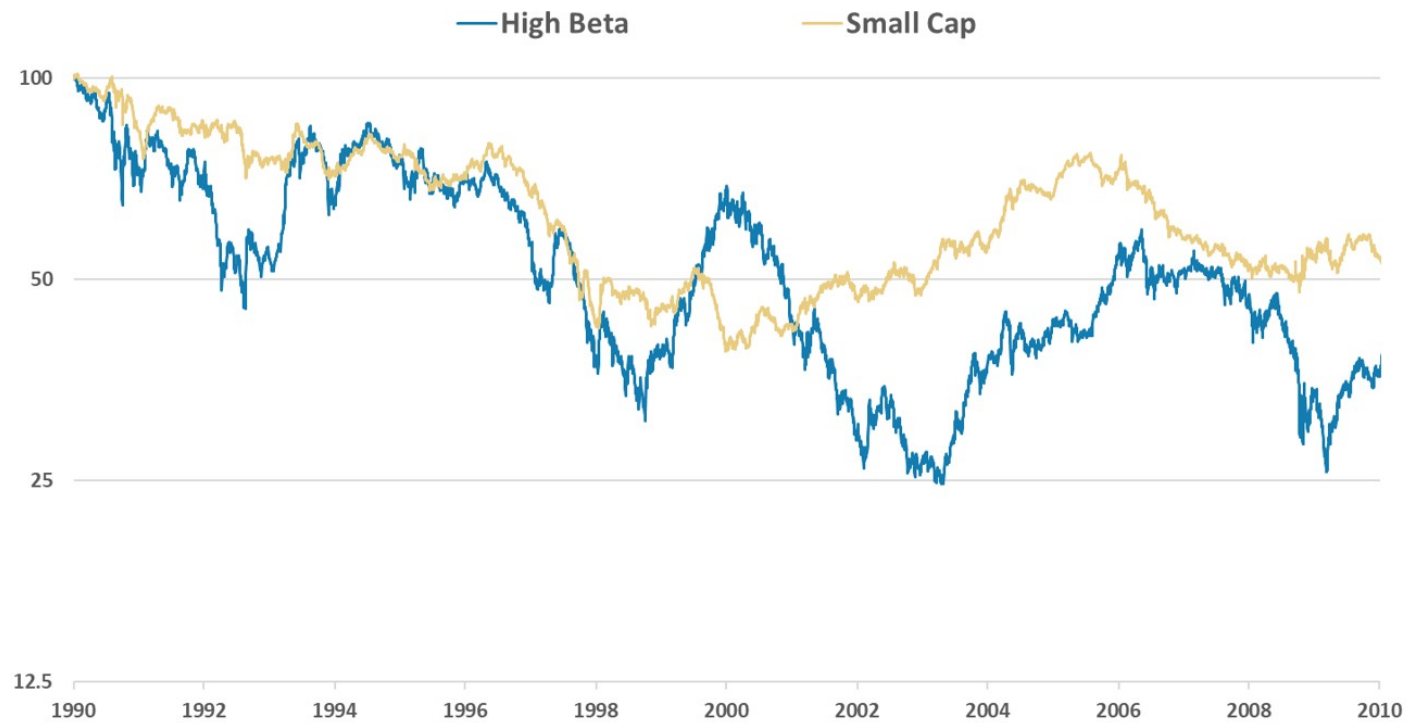
Takeaway (ii) – Trading Dynamics Were Reversal Driven, Especially in Early Years of Deflation



Source: FactSet, Morgan Stanley Research

Alpha Factors in Japan During 1990s

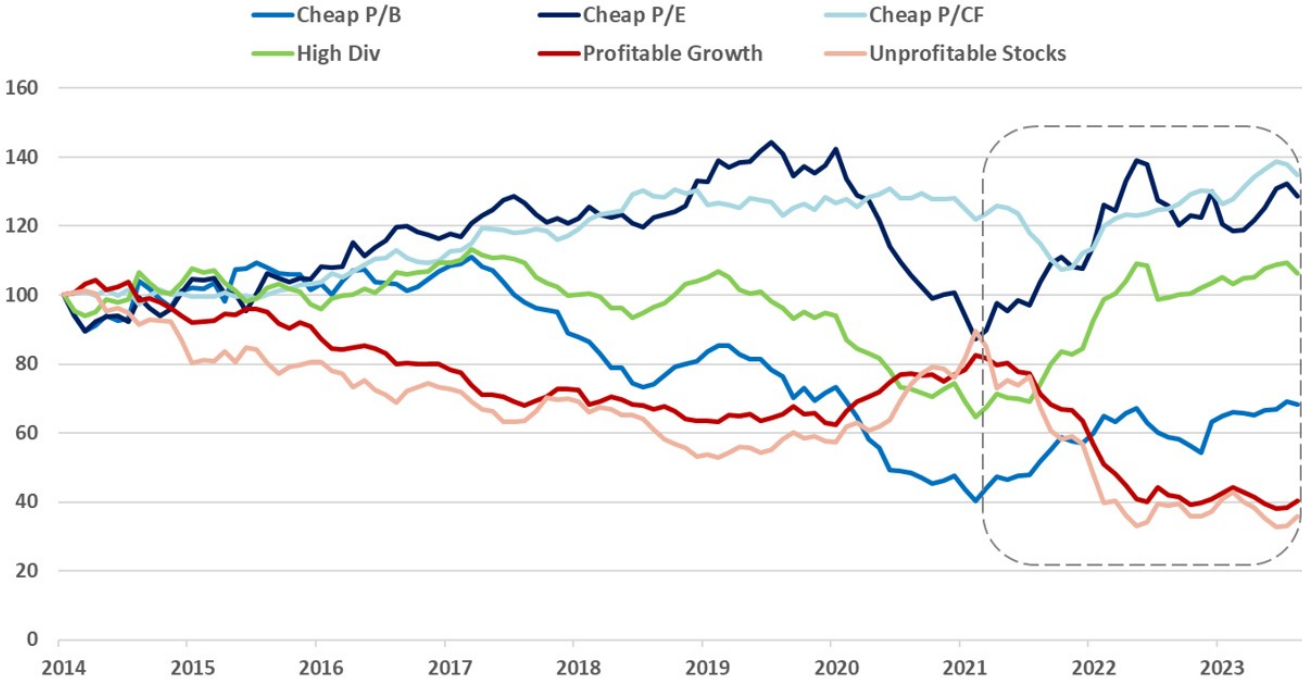
Takeaway (iii) – High Beta Stocks and Small Cap Stocks Could Only Outperform Tactically



Source: FactSet, Morgan Stanley Research

China's Recent Factor Performance

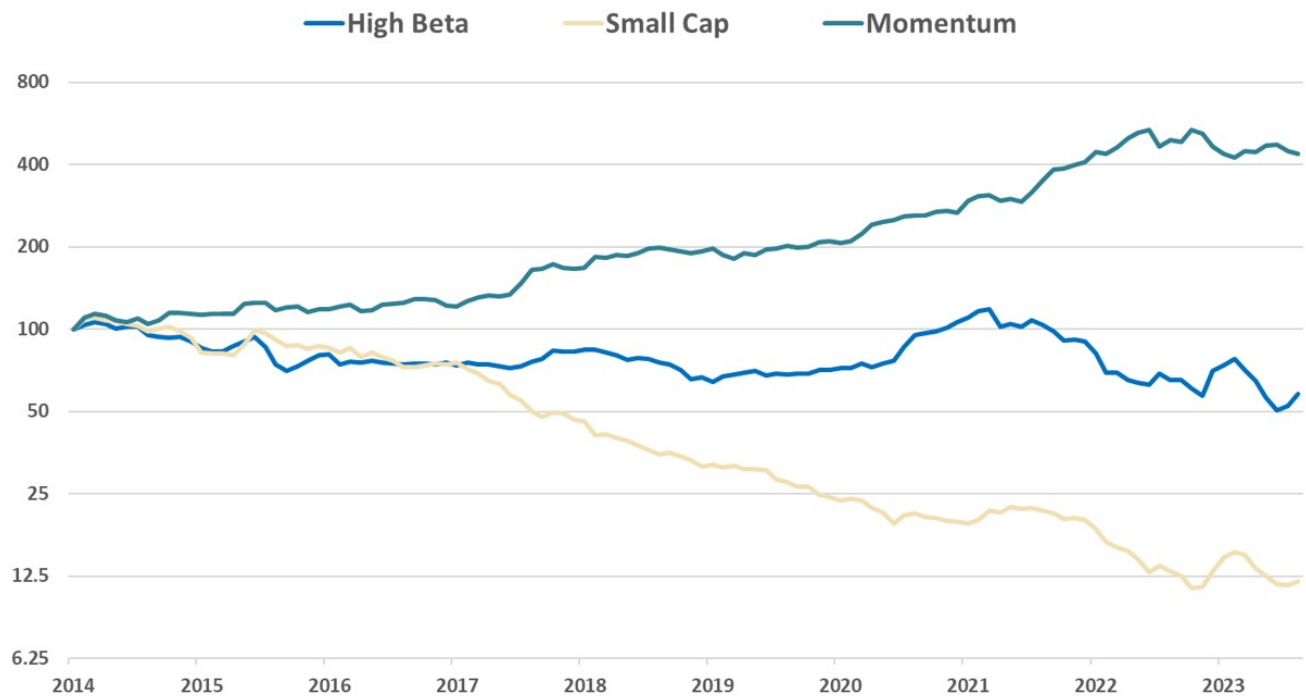
(i) Value Outperformed Growth



Source: FactSet, Morgan Stanley Research

China’s Recent Factor Performance

(ii) Price Momentum Factor Started to Fade in 2022



Source: FactSet, Morgan Stanley Research

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)			Other Material Investment Services Clients (MISC)	
	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MISC
Overweight/Buy	1347	37%	276	43%	20%	609	39%
Equal-weight/Hold	1659	46%	294	46%	18%	717	46%
Not-Rated/Hold	3	0%	0	0%	0%	1	0%
Underweight/Sell	604	17%	69	11%	11%	227	15%
Total	3,613		639			1554	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

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