CIMB PREFERRED INSIGHTS

MAY 2021

Key Highlights

- **Chinese recovery.** China's dual circulation plan focuses on both the domestic consumption market as well as external export oriented strategy.
- **Opening up.** China continues to open up, and more investors are allocating their portfolios to the A-share market for alpha returns.
- **Opportunities**. We explore some Unit Trust ideas that investors can consider for their portfolios:
  - **JP Morgan China A-Shares Opportunities Fund**
  - **Blackrock China Bond Fund**
  - **Schroders Asian Growth**
  - **Schroders Asian Equity Yield**

Long term prospects of China. The "Dual Circulation" strategy was first highlighted at the meeting of the Politburo in mid-May 2020, which was further included in China's 14th Five Year plan (FYP) for 2021-25.

The dual circulation plan comprises of 1) Internal Circulation which focuses on domestic market and 2) External Circulation which focuses on its export-oriented development strategy, while trying to harmonize the both pillars. The idea is to focus on expanding domestic output and demand while at the same time drawing in foreign investment and stabilizing trade.

China has been seeking to rebalance growth towards domestic consumption and upgrade domestic industry and technology with "Made in China 2025" and other innovations. Consumption growth, innovation and modernization of the industrial system will likely play an important role in the 14th FYP.

Given the episodes seen during Covid-19 that have led to a disruption of the global supply chain resulting in less accessible foreign technology or key products, Chinese policymakers have seen an urgent need to upgrade the country's manufacturing sector, and to develop a full spectrum supply chain which is based on self-sufficiency.

To date, China has managed the Covid pandemic well, while still sticking to conventional monetary/ fiscal policies. China has been cognizant of its high domestic corporate debt and is extremely mindful of the ultra-easy monetary policy in many developed nations as well as its own massive stimulus in 2008-09 GFC (which led to surging debt). China has thus been seen pursuing a more prudent and targeted monetary policy of late.

On concerns regarding China's recent tightening, we believe that the bar for any policy hike will be high given the elevated debt level within the economy and the government's preference for financial stability. Hence, we opine that China will likely avoid over-tightening. Over the medium term, China should be focused on promoting quality growth and controlling risk.

China markets continue to open up and thus present opportunities. We believe Investors are allocating into the A-share market as one possible source of alpha returns in their portfolios. As China's market reforms progressed in 2015 and the Qualified Foreign Institutional Investor (QFII) program expanded, there has been increased fundamental analysis works in China that has helped both domestic and foreign fund managers to generate alpha.

Access for foreign investors to China A shares has been improving following significant regulatory changes. In fact, China lifted restrictions entirely for the Qualified Foreign Institutional Investors (QFII) and Renminbi Qualified Foreign Institutional Investors (RQFII) schemes, integrating both programs into one since 2020. We believe that the Chinese government will continue to open up their financial markets, which should present even more interesting opportunities for long term investors.

Source: Bloomberg

China Tech regulation. There were concerns about the recent regulatory stance on several Chinese tech companies, namely Alibaba. On 10 April, the China's State Administration for Market Regulation (SAMR) announced that it had completed the anti-trust investigation on Alibaba and slapped it with a USD 2.8 bn fine (which is a slap on the wrist fine), in our opinion. The amount of the fine looks to serve as a deterrent to other big platforms, but not too big to hurt Alibaba's operations too severely.

We believe that China's increasing control and more hands-on approach should be seen in the context of maintaining financial stability while ensuring that a more level playing ground can be established for the smaller or newer players. We do not think this will make the current large players any less attractive, provided they play by the rules. We do not think that stringent ruling will stifle innovation. We will monitor for signals from regulators indicating a wrapping up of this round of regulatory changes.

For clients looking for growth opportunities, the Chinese economy has undergone a dramatic structural transformation in the last five years, shifting from growth via infrastructure spending to present-day, where consumption, services and the "new economy" sectors are the main contributors of the economy.

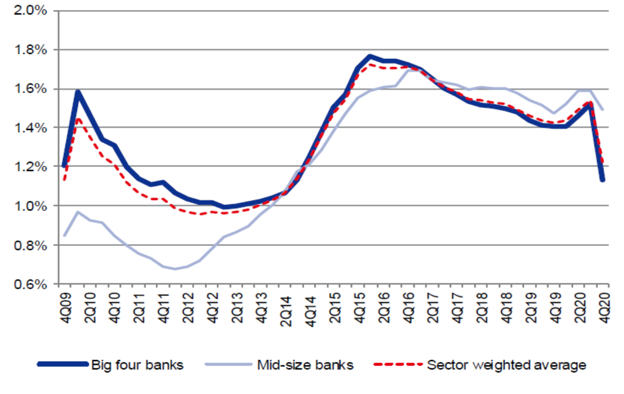
For income investors, such as those searching for yield, the "old economy" sectors may offer attractive dividends and lower valuations, compared to new economy companies with high growth profiles and rich valuations. For instance, some of the Chinese banks and property stocks are considered cheap and offering dividend yields of almost 6%.

We take a closer look at the financials as the backbone to a healthy Chinese market. According to CGS-CIMB Research, they expect the share price out-performance to continue for banks, driven by further asset quality improvements. In the initial phase of the recovery, they believe it was the recovery of profitability spurred the first leg of China banks' share out-performance. Therefore the strong China bank performance only partly unwinds the significant 2020 underperformance of the China banks versus the MSCI China index.

CGS opined that China banks have successfully navigated the twin challenges of a trade war and Covid-19, with much better-than-expected asset quality outcomes. Looking ahead, it is likely that banks' asset quality to improve.

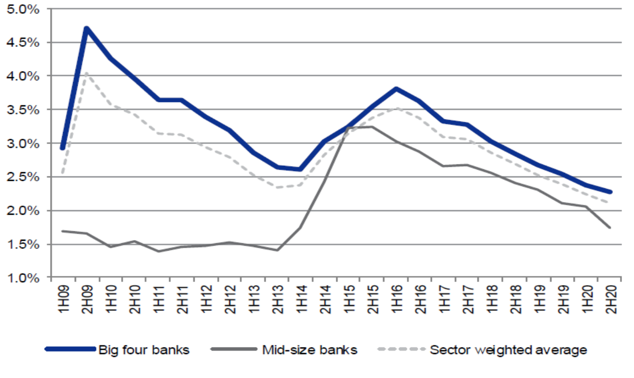
CGS looks at combined NPL and SML ratio and this has been falling in 4Q2020 for the whole system. Banks had been tightening their NPL recognition as well.

Fig 1: NPL ratios of China Banks have recently trending downwards



Source: CGS-CIMB Research

Fig 2: Special Mention Loan (SML) ratios trending down



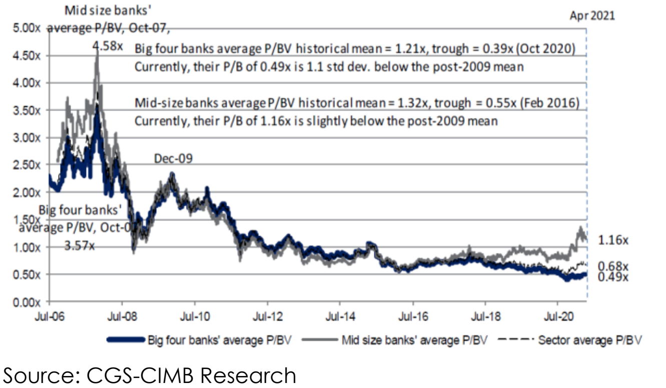
Source: CGS-CIMB Research

Banks tend to benefit from improving economy and it is encouraging that several macro data are near highs. The Li Keqiang Index – created by the Economist to measure China's economy using three indicators of railway cargo volume, industrial electricity consumption and loans disbursed by banks, is at a four year high.

Valuation. The China banks under CGS-CIMB coverage trades at attractive valuation levels. They trades at 0.7x on a 12-month forward P/BV basis, with the big four banks trading at 0.5x on a 12-month forward P/BV basis. The sector trades at 0.7 standard deviation below the post 2006 mean, while the big four banks trades at 1.1 standard deviation below the post-2006 mean.

The dividend yield of the big 4 China banks is on average 7% in April 2021 on a 12-M rolling forward basis.

Fig 3: China banks' 12-month forward P/BV since 2006



Source: CGS-CIMB Research

China banks are much more "investable" now. Stricter NPL recognition, sizeable provisioning buffers, easing concerns over policy risks amidst an improved economy, significantly reduced NPL formation, the end of monetary easing which indicates a more positive Net Interest margin and increased regulatory risk in new economy sectors led investors to see China banks as more investable now.

Property developers. Despite Covid-19, the Chinese developers recorded better-than-expected sales growth of 13% in 2020. For 2021, they target a 10%

contracted sales growth. CGS-CIMB Research expects core profit to up 15% for FY21F.

CGS think housing policy will remain relatively tight in 2021, especially in 2nd and top tiered cities, whose home prices and land prices are still strong. Tough regulatory requirements, coupled with a competitive of land market, could lead to faster market consolidation, which should benefit developers with strong balance sheet and execution capabilities.

CGS expect developers to meet the Three Red Lines by 2023. Given proactive deleveraging ahead, CGS-CIMB Research expects the number of developers (under their coverage) to attain the Green category under the Three Red Lines to rise. Developers need to comply with these requirements to continue to get financing.

Sector trading at 5.4x FY21 PER and 7% dividend yield is attractive. Chinese financial system remain well anchored by sound policies. Chinese regulators introduced tighter regulations to the property sector to get sector to deleverage. This bodes well for sector development as this will drive further credit divergence to weed out weaker players and accelerate consolidation within the industry.

For opportunities considering the reasons mentioned, investors may consider the following funds:

JP Morgan China A-Shares Opportunities Fund or **Blackrock China Bond Fund**

For more exposure into the greater Asian region, investors may also consider the **Schroders Asian Growth Fund**, or **Schroders Asian Equity Yield Fund**.

Please speak to your Relationship Manager for more details.

Disclaimer

CIMB Bank Berhad, Singapore Branch has produced this publication/email/report/commentary for private circulation to CIMB Preferred Clients in Singapore only. This publication is being supplied to you strictly on the basis that it will remain confidential. No part of this report may be (i) copied, photocopied, duplicated, stored or reproduced in any form by any means or (ii) redistributed, published, circulated, reproduced or passed on, directly or indirectly, to any other person in whole or in part, for any purpose without the prior written consent of CIMB Bank Berhad, Singapore Branch.

This publication/email/report/commentary has been prepared by CIMB Bank Berhad and/or its related and affiliated companies and/or any individuals connected with the aforementioned entities (hereinafter "CIMB") and is solely for information and discussion and information purposes only. This publication/email/report/commentary should not be construed as a recommendation, an offer to sell or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. CIMB is also not acting as an advisor or agent to any person to whom this report is directed in respect of its contents. A copy of the prospectus of each fund is available and may be obtained from the relevant fund manager or any of its approved distributors. Potential investors should read the prospectus for details on the relevant fund before deciding whether to subscribe for, or purchase units in the fund. The value of the units in the funds and the income accruing to the units, if any, may fall or rise. Please refer to the prospectus of the relevant fund for the name of the fund manager and the investment objectives of the fund.

Whilst CIMB has taken all reasonable care to ensure that the information herein has been compiled from sources believed to be reliable and is not untrue or misleading at the time of publication, CIMB assumes no responsibility and makes no representations or warranties, of any kind, as to the accuracy or completeness of this publication/email/report/commentary and this publication/email/report/commentary does not purport to contain all the information that a recipient may require. CIMB makes no express or implied warranty as to the accuracy or completeness of any such information and opinion contained in this report. The information and any opinion contained in this publication/email/report/commentary are subject to change without notice. Neither CIMB nor any of its affiliates, advisers or representatives are obliged to update any such information subsequent to the date hereof. Any reference to a company, financial product or asset class is used for illustrative purposes and does not represent a recommendation in any way. The projections, valuations and statistical analyses herein may be based on subjective assessments and assumptions and may use one of many methodologies that produce different results and to the extent that they are based on historical information, they should not be relied upon as an accurate prediction of future performance. The price and value of any investments and indicative incomes herein contained may fluctuate either positively or negatively. It should be noted that investments in emerging markets are subject to increased levels of volatility than more established markets. Some of the reasons for this volatility relates to the respective economy, political climate, credit worthiness, currency and general market within that country. When investing in investments denominated in a foreign currency these transactions are also subject to fluctuation in exchange rates.

Certain transactions mentioned in this material may give rise to substantial risks and may not be suitable for all recipients. Please refrain from acting on the information herein without first independently verifying its contents.

This publication/email/report/commentary is intended for general circulation only. Nothing in this publication/email/report/commentary constitutes a representation that any recommendation herein is suitable or appropriate to a recipient's individual circumstances. This publication/email/report/commentary does not take into account the specific objectives, financial situation or particular needs of any recipient given that it is not possible for CIMB to have regard to the investment objectives, financial situation and particular needs of each person who reads this report. Before you make an investment, please consult your CIMB relationship manager regarding the suitability of any investment product based on your investment objectives, financial situation or needs. If you choose not to do so, you should consider whether the investment product is suitable for you. Please seek independent professional legal and financial advice as to the contents of this publication/email/report/commentary and the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you commit to purchasing a product. For the avoidance of doubt, the recipient of this publication/email/report/commentary should not treat such content as advice relating to legal, accounting, taxation, technical or investment matters.

Neither CIMB nor any of their directors, employees or representatives accept any liability for any loss, damage, costs, charges or expenses of whatsoever nature and howsoever arising (including but not limited to direct, indirect, special or consequential loss or loss of profits or loss of opportunity) suffered by you or any third party in connection with the use of this publication/email/report/commentary or its content (including any error, omission or misstatement herein, even if CIMB has been advised of the possibility thereof). CIMB, its affiliates and its related companies do and seek to do business with the company(ies) covered in this publication/email/report/commentary and may from time to time act as market maker or have assumed an underwriting commitment in the securities or instruments mentioned in this publication/email/report/commentary and, together with its associates and related companies, their directors, officers, employees and/or agents, may have or take positions or other interests in, and may effect transactions in securities or instruments mentioned herein and may also perform or seek to perform broking, investment banking and other banking or financial services for the companies or issuers mentioned herein and the affiliates of such companies or issuers.

The views expressed in this report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the analyst(s) was, is, or will be directly or indirectly related to the inclusion of specific recommendations(s) or view(s) in this publication/email/report/commentary. CIMB prohibits the analyst(s) who prepared this publication/email/report/commentary from receiving any compensation, incentive or bonus based on specific investment banking transactions or for providing a specific recommendation for, or view of, a particular company. However, the analyst(s) may receive compensation that is based on his/their coverage of company(ies) in the performance of his/their duties or the performance of his/their recommendations and the research personnel involved in the preparation of this publication/email/report/commentary may also participate in the solicitation of the businesses as described above.

The authors of the report do not own any specific securities that are recommended (shares and bonds). However, they may own units of mutual funds but these are diversified in nature and do not benefit from the price movement from single securities.

The authors are not privy to whether or not CIMB is involved in any relationship with any of the recommendations detailed in this report.

In addition, any opinions or views of third parties in this report are those of the third parties identified, and not those of CIMB. CIMB may have alliances with product providers, for which we may receive a fee. Product providers may also receive a fee from investors.

This publication/email/report/commentary is private and confidential and is for the addressee's attention only. This publication/email/report/commentary is intended for clients of the Preferred Banking Department of CIMB Bank Berhad, Singapore Branch only. If you are not the intended recipient and have received this publication/email/report/commentary, you may not use, copy or disseminate the information contained herein or hereto attached. Please also notify the sender/originator of the publication/email/report/commentary of the error and destroy the publication/email/report/commentary and/or delete the publication/email/report/commentary from your computer and system. We do not assure the security of information electronically transmitted, and your communication with us or request for communication through such means shall signify your acceptance of such risk.

The information herein is not directed to, or intended for distribution to, or use by, any person or entity who is a citizen or resident of a locality in any jurisdiction, state or country where such distribution, publication, availability or use would be contrary to law or regulation.

If at any time any provision or part of any provision, of this disclaimer is, or becomes, illegal, invalid or unenforceable in any respect under the law of Singapore, that shall not affect the legality, validity or enforceability of any other provision, or part of that provision, of this disclaimer.

CIMB Bank Berhad (13491-P)