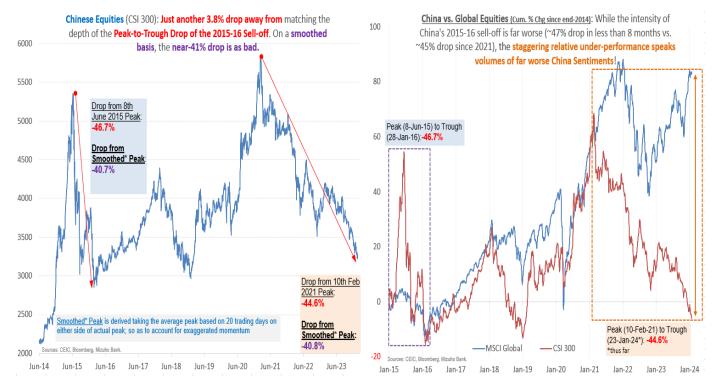




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China Equities: Why the Pain May be More Acute this Time



"Crime is common. Logic is rare. Therefore it is upon the logic rather than upon the crime that you should dwell." - Sherlock Holmes

- The depth of China's equity gloom, partly reflecting an unprecedented confidence deficit in the economy, is far worse than it first appears. In fact, by some measures, things are significantly worse than in 2015-16, which saw an almost 47% drop in equities from peak to trough (in just 8 months).
- Admittedly, at face value it is not, as yet, severe as the sell-off eight years ago. Recent peak to trough is a tad less at ~45%. What's more, the **intensity of the sell-off is not quite as brutal as in 2015-16**, with this decline spanning nearly 3-years (Feb 2021 to now).
- *But* that is hollow consolation. For one, on a smoothed basis, the current sell-off doesn't look any better. And to be sure, **despite compelling assurances of emphatic and "forceful" support** by Premier Li Qiang, the *current sell-off might not* have necessarily been *stemmed durably*.
- Crucially, any comfort from **comparatively milder intensity of sell-off this time** is woefully misguided; as the diminished intensity **masks more dire relative valuation and sentiments**.
- Fact is, the 2015-16 episode, as sharp as it was, appears to have mostly reflected an onshore China bubble phenomenon; in which, an exaggerated and (leveraged) speculation-fuelled bull market far surpassing global equity market dynamic/momentum proved unsustainable.

- And in the 2015-16 instance, with "national team" support of state-driven investment backstop, equities found a durable bottom in line with global markets and recovered in tandem after.
- In sharp contrast, this time, China's sustained sell-off is taking place *despite* the rally in global equities. And rather than a delayed convergence in relative shifts, with the re-opening in China, the divergence has only worsened over time.
- This could be framed both ways. On one hand, the argument of under-valued Chinese equities primed for a resounding (and highly rewarding) come-back is a narrative that is not without resonance (or for that matter, temptation) with some pockets of the markets.
- But on the other, the dire reality of relative under-valuation justifiably reflecting requisite geopolitical and socio-economic risk premia (entailing structurally more elevated geo-political uncertainty conspiring with private sector confidence deficit) simply cannot be dismissed. And in fact, is the more compelling and binding narrative here.
- That being the case, a **rescue package alone cannot guarantee panacea for beaten down Chinese equities**; as it *may only inspire private sector opportunism* (where knee-jerk support fizzles) *but risk falling short of bona fide confidence* needed **to durably restore self-sustaining support**.
- And so, to properly address the current equity market malaise, which reflects deeply entrenched economic, geo-political and policy uncertainty/doubts, the requisite policy impetus from Beijing must comprise a confluence of convincing appetite for Draghi-style, "whatever it takes" liquidity pump-priming to arrest what may otherwise be a self-reinforcing meltdown; backed by economic stimulus (with policy visibility) to revive animal spirits and confidence durably
- As Homes alluded to, it is not the "crime" of equity market sell-off but rather, the "logic" driving this slower-burn, more sustained sell-off that is in defiance of global equity market momentum/valuations that policy-makers ought to focus on.
- Until then, the *dangers of renminbi stability being held hostage by the equity market sell-off* remain well and alive; as contagion effects from **equity market sell-off teetering on** wider financial stability invoke **heightened risks of capital outflows**.

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