

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 geo-political 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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