



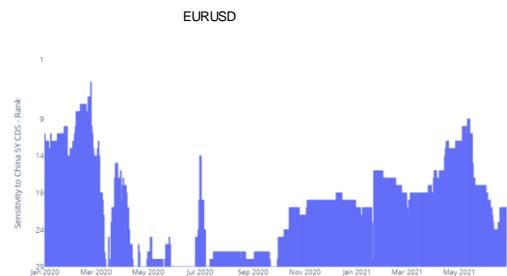
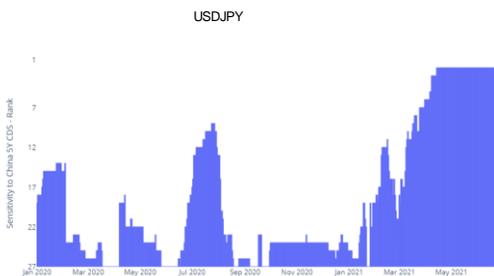
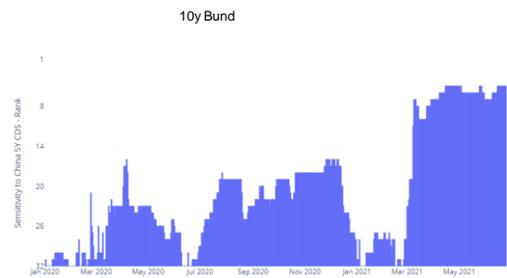
## Hedging China

- A key macro theme for H2 2021 is the normalisation of the Chinese policy stance & the implications for slower growth. Falling credit impulse data, for example, is getting a lot of attention.
- **This has been a growing theme on Qi as well with China-related factors rising in importance.** The charts take six global benchmark assets - S&P500, Euro Stoxx 600, 10y US Treasury & 10y Bund yields, plus EURUSD & USDJPY - & shows the ranking of Chinese sovereign CDS as a driver amongst the entire model factor set.
- **The higher the ranking, the more important this measure of Chinese sovereign stress is for that asset.** Sovereign CDS can be interpreted as insurance against default risk. Wider (narrower) spreads implies there is greater (less) demand for protection against a Chinese credit event.
- China stress is a top 5 driver for [10y US Treasuries](#) & [Bunds](#). However, it is US rates which really stand out. It is **the second biggest driver in the entire factor set - second only to crude oil. A one standard deviation widening in Chinese CDS currently equates to a 10bp decline in UST yields.**
- US & European equity benchmarks were highly sensitive to China in May but that has fallen in June. Note though model confidence for the [S&P500](#) is now 62% - it has fallen out of regime. Declining sensitivity could reflect a broader shift away from macro rather than the driver itself.
- **China stress is the second biggest driver of [USDJPY](#).** The relationship is positive – turbulence in China is consistent with higher USDJPY. That paints a mixed picture since USDJPY's sensitivity to traditional risk aversion metrics (VIX etc) have recently re-established a negative relationship. After months early in 2021 when spikes in VIX benefitted the Dollar, they now favour the Yen once again.
- This demonstrates that **not all 'risk off' episodes are created equal.** The catalyst for a deterioration in risk appetite can vary. Choosing the right hedge first requires the ability to recognise the source of 'risk off'; but then to know which assets are sensitive to that particular move.



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- Relative factor rankings. The charts show how important a factor – China sovereign stress – is within the whole factor set. A ranking of one means it is the variable with the biggest impact on that asset. A lower ranking implies that driver has comparatively little effect on price action.
- **China sovereign stress is a top 5 driver for US Treasuries, 10y Bunds & USDJPY.**



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