Lockdown vs. Re-opening
How to understand your China exposure

November 30th 2022

Summary

- One way Qi can help investors navigate China dynamics is to screen your portfolio for sensitivity to our **Chinese macro factors**.

- This case study looks at the October / November period when markets got excited that China's Covid rules would be relaxed & a re-opening trade helped fuel a 'risk on' rally in markets.

- The results show the US stocks with the smallest sensitivity to Chinese macro factors effectively performed in line with the broader US equity market. But **the ten picks with the greatest China exposure outperformed the S&P500 by 5.6%.**

Measuring Macro

In September we demonstrated the efficacy of Qi's macro factor sensitivities. "*How to outperform tighter financial conditions*" screened a portfolio of US stocks for their sensitivity to US real yields & US High Yield credit spreads.

Those two factors were the key drivers of US equity models in mid-August. That was when a Qi client came to us asking for a customised hedge ahead of Fed Chairman Powell's pending speech at Jackson Hole. A speech people feared would be hawkish and reverse the summer's relief rally in equity markets.

The results were exceptionally strong – while the S&P500 fell 14% in the weeks after Jackson Hole, **Qi's list of the ten most vulnerable stocks fell 21%; our list of ten resilient stocks fell just 12%.**

So here we perform the same exercise but this time training a portfolio of US stocks on our China factors.

USDCNH peaked on November 2nd before a wave of optimism spread through markets for a relaxation of lockdown rules. We measured sensitivity of US stocks to our China factors a month prior to that on October 3rd and ran the exercise through to Thanksgiving.

China factors

Amongst others, all our equity models include the following factors

- Now-Casting tracking GDP for China
- Copper
- USDCNH fx

Between them they capture Chinese economic growth directly, copper as a proxy for Chinese industrial demand & the currency markets reflection of Chinese economic, political & financial health.

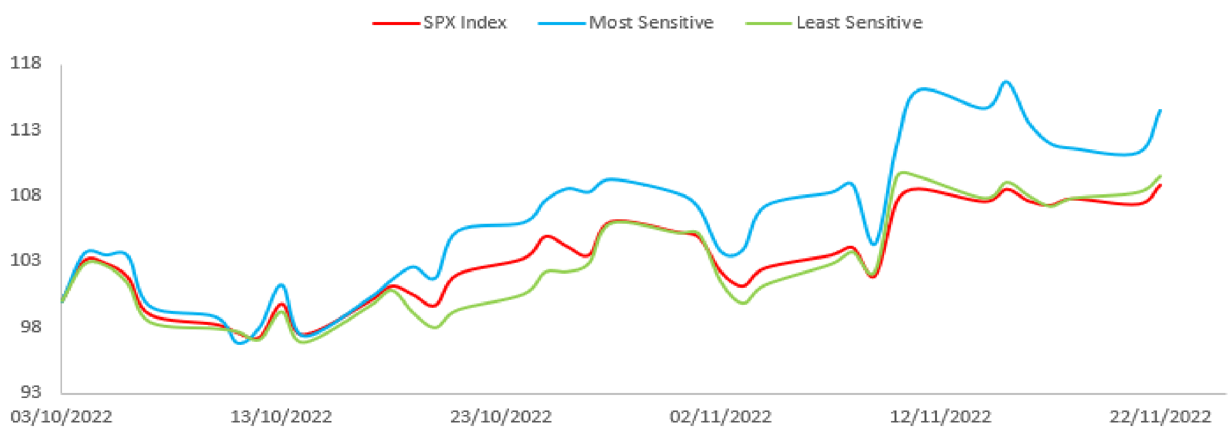
We screened the S&P500 for stocks in a macro regime (model confidence of at least 65%) and sensitivity to these three factors to create two equally weighted baskets of ten stocks.

- The ten stocks that stand to benefit from any China re-opening trade: they want stronger China GDP & Copper plus lower USDCNH.
- The ten stocks with the least sensitivity to our China factors, i.e. potential laggards in any China-led rally.

Results

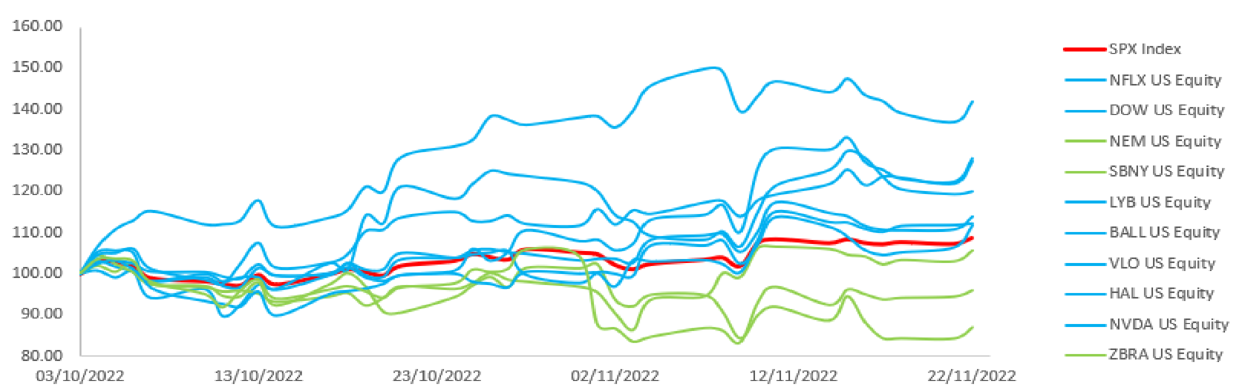
While the S&P500 had rallied 8.9% leading up to Thanksgiving, the **Qi basket of Chinese re-opening stocks rallied 14.5% - a 5.6% outperformance.**

This time the prospective laggards did not perform as desired. Instead of underperforming they rose 9.4% over the period – a modest 0.5% outperformance.

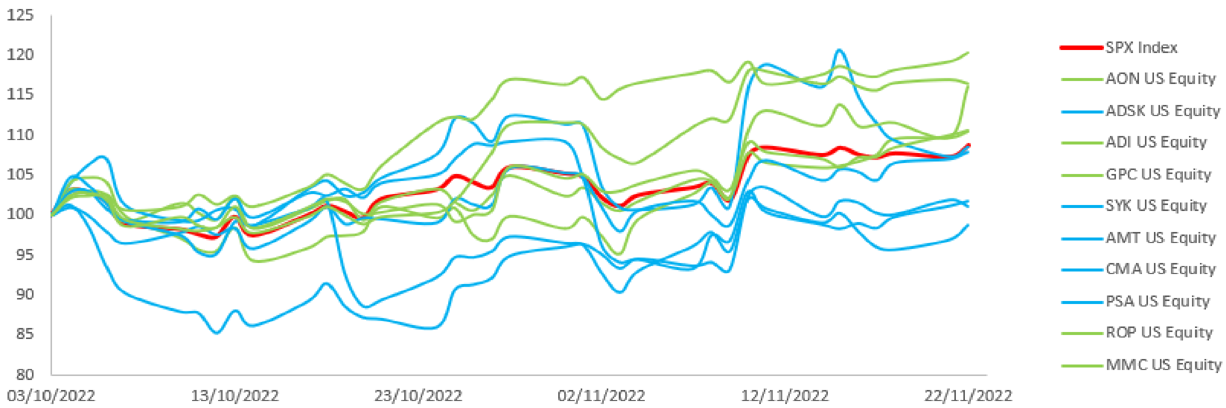


Break-down

Amongst the ten most sensitive names, seven beat the S&P500 over the period, three lagged.



Amongst the stocks that screened as least sensitive to Chinese macro conditions, it was a 50:50 split. Hence this basket effectively performing in line with benchmark.



Conclusion

- These are macro markets and 2023 won't change that. The topics will shift from Fed rate hikes to whether the global economy experiences a soft or hard landing, or the degree to which China re-opens.

- Either way, investors cannot afford to ignore macro. Ideally, they need a robust quantitative framework that enables them to measure the impact of macro on their portfolios.

- Using Qi macro factor sensitivities worked superbly for US Financial Conditions over the late summer. Qi's pick of resilient US single stocks **outperformed the most vulnerable by 7% and the S&P500 by 3%.**

- This time, looking over the market's recent flirtation with a Chinese re-opening, using Qi's macro factor sensitivities resulted in a **net outperformance of 5.1%.** The laggard leg of the trade marginally detracted from performance, but the beneficiaries did significantly better.