Quant insight

19.01.2024

Qi Stock Spotlight
- The Disconnect between China Risk & DM equities

Qi analysis reveals a stark disconnect between China sentiment and DM risky assets.

Qi has screened European & US stocks most sensitive to China growth expectations. On both sides of the Pond, these stocks have propelled higher since late Autumn, diverging from Chinese equities which have fallen to 5yr lows.

Why? Clearly domestic growth relative to domestic financial conditions have mattered more. This is another example of how well DM equities have priced the soft landing narrative – there is little margin for error.

Qi has created a China exposure basket, designed to track China growth expectations as proxied through USDCNY, out-of-sample.

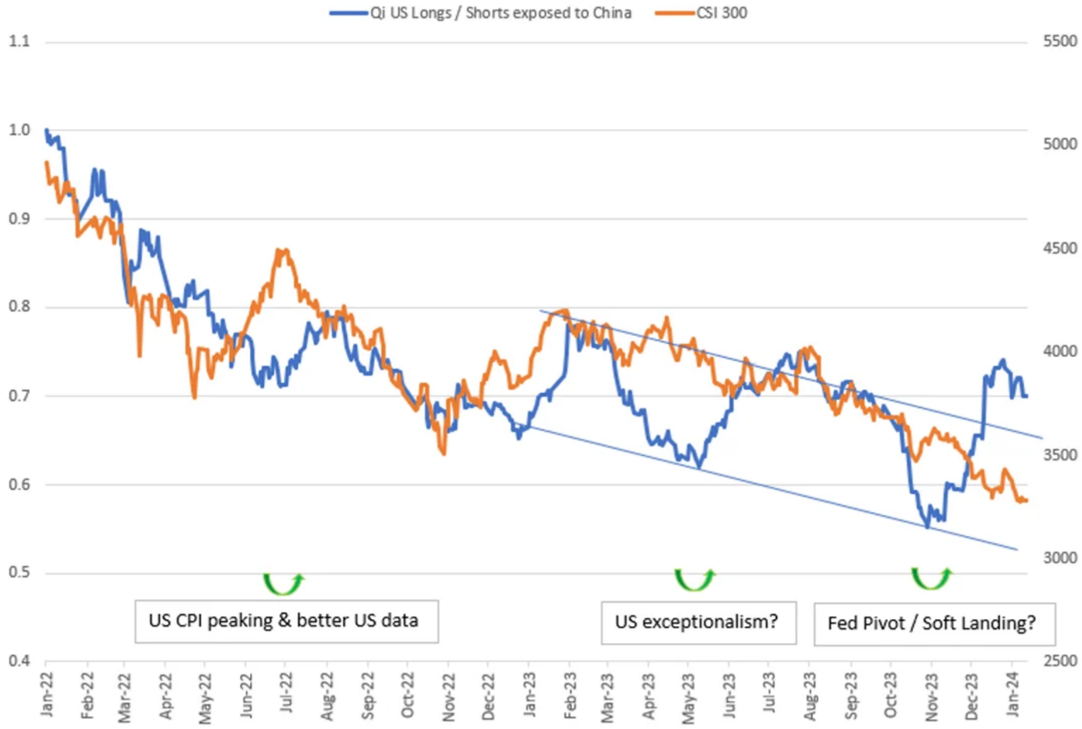
An opportunity to be Long FXI / Short Qi's China exposure basket? Qi shows the current divergence is an opportune entry point if you believe the risk of inflation accelerating is higher than the market is pricing.

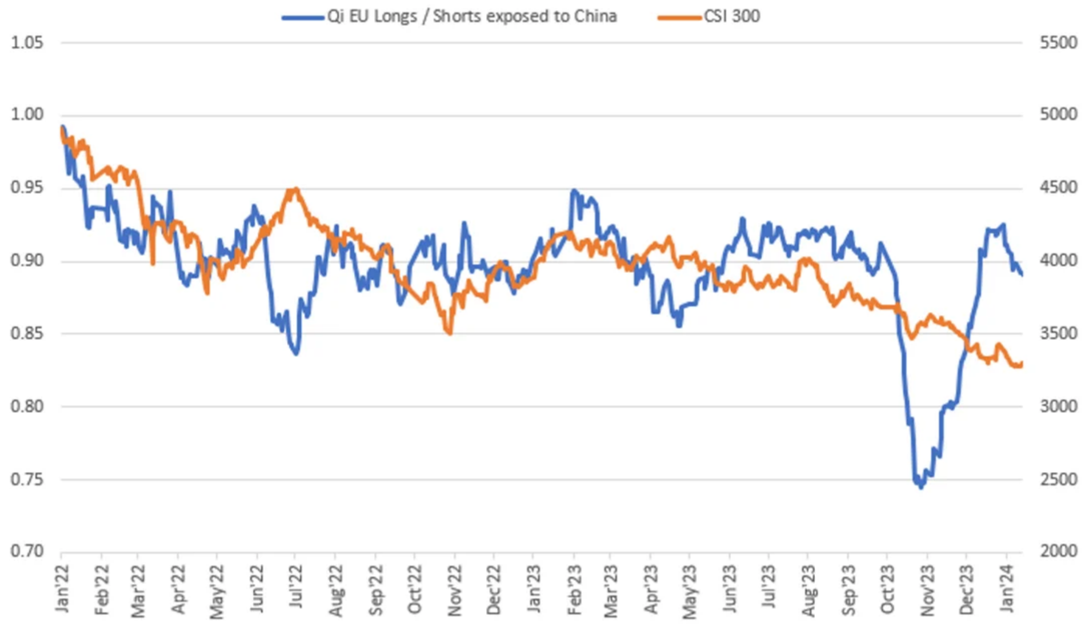
Chinese equities have been in the red for 3 consecutive years – unprecedented in modern history. Valuation is never enough – decisive and effective policy delivery is needed alongside an exit from deflation. While China deflation may be welcomed by the world, Qi analysis shows a **glaring disconnect between China sentiment and DM risky assets**.

Qi screened European and US equities most sensitive to China growth expectations. Qi provides macro driver sensitivity exposure, for a large factor information set, across the global single stock universe. We use this data to identify names most exposed to China. This is defined as the sensitivity to China GDP (positive), Copper (positive), Iron Ore (positive), China 5y CDS (negative), USDCNY (negative) and VXEEM (negative).

The performance of the 30 most exposed relative to the 30 least exposed in both regions is shown below. Note this is based on the prevailing sensitivities of stocks today – the names are fixed with no rebalancing. At any one time, risky assets are driven by a host of moving macro drivers, making a static screen somewhat naïve (see more details below).

However, the charts below make a simple point – **DM equities exposed to China trade rich relative to the underlying Chinese equity market**. This should not surprise, given the domestic growth / inflation focus. However, this is another example showcasing the **reliance on a soft landing narrative**





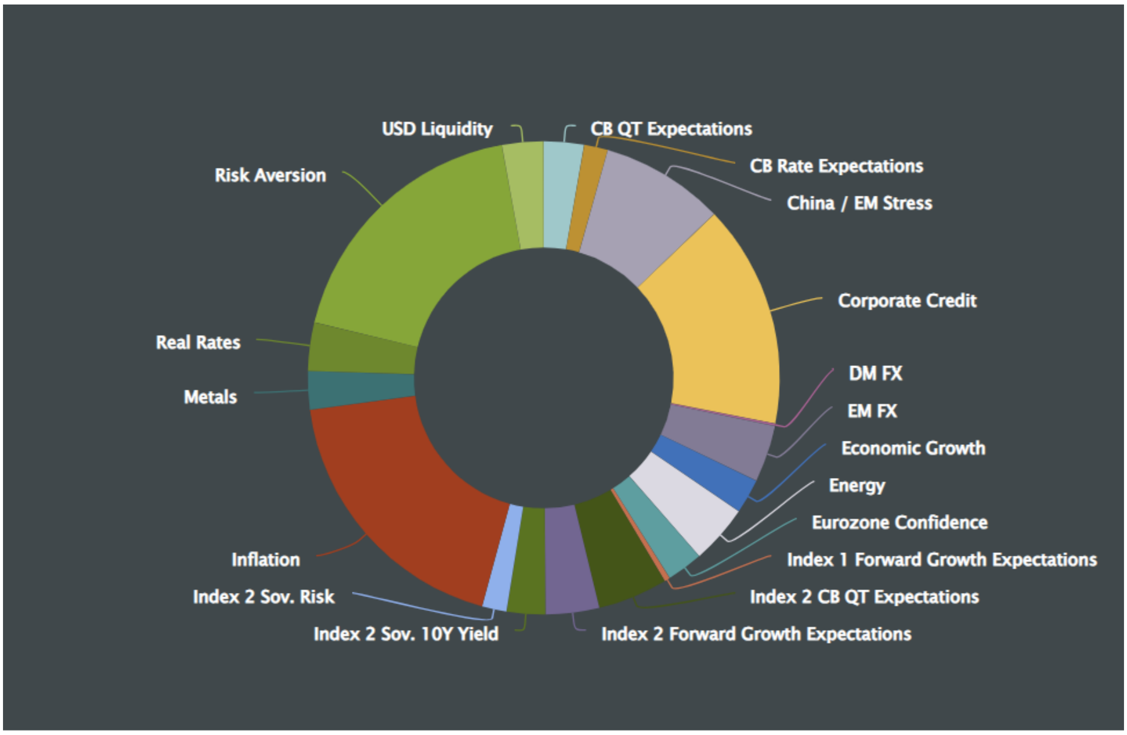
Qi has created a China exposure L/S equity basket using the S&P500 universe. This uses Qi's proprietary optimisation process which looks at all the possible combinations of stocks and their weights that minimize the tracking error to the macro factor in question.

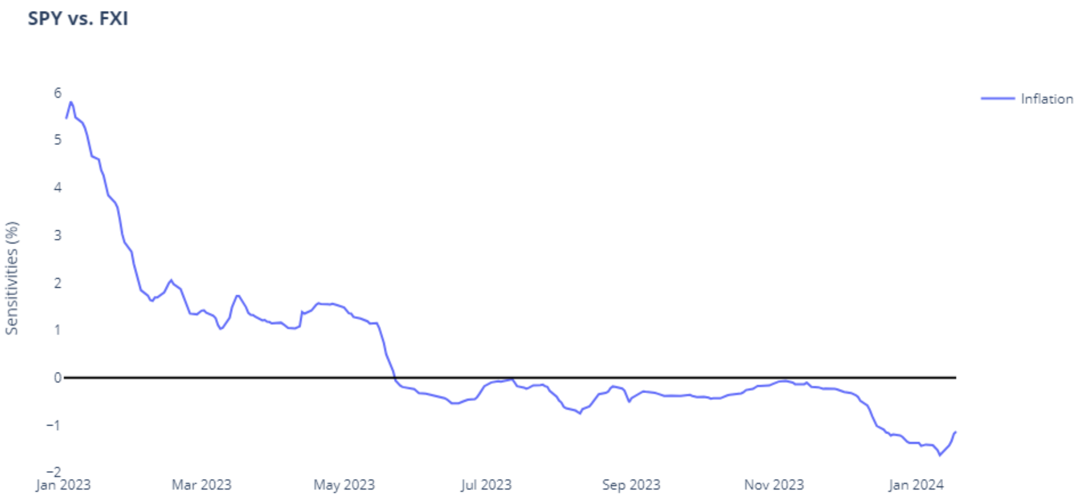
This is run out-of-sample for a month, until the next monthly rebalance. Qi baskets are available to trade via Goldman Sachs. Specifically, the chart below shows the performance of the GSQICFXS / GSQICFXL ratio.

The divergence in performance between the Qi L/S Basket and the CSI 300 (indeed also FXI) has extended since Q4 last year. Is now the time to play for re-convergence, i.e. for a US investor to be long FXI and short China exposed US equities?

To provide clues, Qi shows that the biggest driver of US equities outperformance over China today is inflation expectations: **US wants disinflation to continue / China is looking for a way out of deflation**. The sensitivity to inflation expectations for the ratio SPY / FXI is shown below.

In other words, for investors who are more concerned from here about inflation acceleration risk than China risk, this may present a timely mean-reversion opportunity. More details on this basket is available on request.





Read the PDF

Quant Insight Limited
Dawson House
5 Jewry St
London
EC3N 2EX
UK

Quant Insight Limited, Dawson House, 5 Jewry St, London, London EC3N 2EX, UK

Unsubscribe Manage preferences