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HEARD ON THE STREET

Chinese Stocks Glimpse Light at the End of the Tunnel

China's central bank is tilting dovish as Fed and most other major central banks increasingly lean the other way

Chinese indexes are off to a decent start in 2022, with the MSCI China up versus a decline for the S&P 500.

PHOTO: QILAI SHEN/BLOOMBERG NEWS

By *Jacky Wong*

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Chinese stocks had a terrible 2021. This year could be better, in no small part because China's government finally looks ready to relent on some of the fierce policy measures that hammered them in the first place.

U.S. investors in the market for a bit of diversification in the face of an increasingly hawkish Fed could do worse than cast their eyes east.

Index performance

Source: FactSet

Chinese indexes are off to a decent start in 2022: The MSCI China has gained 2.5% so far versus a 7.7% decline for the S&P 500. U.S. stocks have been hit hard by investor perceptions that the Federal Reserve could raise rates sooner and faster than seemed likely just a few weeks ago.

Historically, Chinese stocks have usually performed poorly early on in Fed tightening cycles, according to Goldman Sachs. But this time around, China's central bank will likely buck the tightening trend of its peers in most other major economies. The People's Bank of China has started easing more aggressively since late 2021. Last week it cut a few key lending rates, including one that is commonly used for mortgages.

That is a sign that Beijing's policy priorities are shifting: The government is getting increasingly uncomfortable with the severe economic drag from the property downturn, which began in the middle of last year. China has been curtailing the flow of credit to its real-estate sector in a bid to rein in massive leverage built up from the reckless expansion of developers such as Evergrande.

Beijing's wide-ranging regulatory crackdown on the internet-technology sector was another significant driver of the selloff in Chinese stocks last year. The MSCI China fell 23% in 2021, compared with a 27% gain for the S&P 500. Index heavyweight Alibaba lost nearly half of its market value in 2021, while tech giant Tencent fell 19%.

The MSCI China is now trading at 12.1 times next 12 months' expected earnings, a bit lower than its five-year average, according to Goldman Sachs. The tech selloff has certainly pulled down its valuation, but stocks in other sectors have also gotten cheaper.

To be sure, many factors still cloud the outlook. Beijing's regulatory campaign against the tech sector isn't over. Policy easing will probably help the housing market as a whole, but the financial situation of many developers remains dire. And the Omicron variant of Covid-19 poses another risk, particularly to consumption, as China may intensify already restrictive existing measures to maintain its Covid-zero approach.

But after the heavy selloff of last year and with a more accommodative central bank as a new tailwind, the worst may be over for Chinese stocks.

Write to Jacky Wong at jacky.wong@wsj.com

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