

January 2016 marked the biggest single month decline in 20 years for A-Shares, with no signs of the usual Spring Festival Red Envelopes effect. For the month, the SSE Composite Index fell 22.65%, the Shenzhen Component Index fell 25.64%, the SME Board Index fell 25.27%, and the ChiNext Index fell 26.53%. The lifespan of hot investments and themes are short and cycling noticeably faster than in 2015, demonstrating a lack of investor confidence and lower risk appetite.

In terms of domestic factors, the decline experienced in the first month of 2016 may be the combined effect of capacity reduction as a part of supply-side reform, maturity of lock-up periods for major shareholders, circuit breaker mechanisms exacerbating volatility, and concerns over forced closing of equity pledge positions. In terms of international factors, the US has entered a rate hike cycle, causing global capital flows to change direction. As significant capital outflow from emerging markets continue, there is increasing pressure for RMB to depreciate. Hong Kong, Japan, NASDAQ, and most other major markets around the world posted various levels of decline. Commodities indices, represented by crude oil and the Baltic Dry Index, also continued to set record lows.

Whether the market can consolidate depends on whether the exchange rate and economy can stabilize. February will be a relatively quiet period in terms of policy signals due to the Spring Festival holidays and the advent of the NPC and CPPCC. As such, market expectations are relatively less certain; the market will again try to find a bottom, but there is no need to be too pessimistic. On the one hand, the US Federal Reserve announced at the January FOMC meeting that rates will remain unchanged and hinted at concerns over the US economy. This temporarily alleviated investor concerns over emerging markets' currency depreciation and capital outflows; it also gave China's domestic monetary policy more room to maneuver. On the other hand, after the swift market correction, valuations have returned to relatively reasonable levels. The profitability and earnings quality of listed companies in consumption structure upgrade-related and traditional industries reform and transformation-related sectors will be validated by their 2015 performance results. Given the current market environment, the risk-reward ratio of these quality stocks will be very attractive.

Considering all of the above, we believe that, going forward, the market will remain volatile but the situation will become more comprehensible. Under the main themes of consumption upgrade and reform and transformation, investors may capitalize on opportunities in the cultural, education, biomedical, healthcare services, and intelligent equipment sectors, etc. We advise picking stocks of companies with clear earnings models, distinct competitive advantages, forward-looking strategic thinking, and reasonable earnings and valuations.