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IDEA

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China Market-Wise | Asia Pacific

What Happened? What Next?

Concerns over selling caused by trust tax, pressure on e-commerce, a weakening macro and elevated global market volatility has caused an acceleration of China's market correction. Historical valuation trough implies 10-15% further de-rating. Still favor A-shares on more signs of National Team effort.

Persistent drawdown since Aug with acceleration lately: The broad China equity market had experienced major and persistent draw-down since early August, with momentum accelerating since mid-October. YTD MSCI China, Hang Seng, and CSI300 have delivered -20.3% , -9.5% and -11.4% absolute returns so far, while performance for these indices since the start of Aug, and since Oct 8th, are -12.8%, -10.4%, -10.6%, and -5.7%, -2.5% and -4.8%, respectively. In fact Oct 22nd recorded the largest single day index price correction YTD for HSTECH, dropping by 5%.

We had already turned more cautious on Sep 3 with price target cuts because... (China Market-Wise: Cutting Index Targets amid Macro and Liquidity Headwinds [3 Sep 2026]) we saw the upcoming Fed hikes and tighter liquidity, a weaker macro, limited flow and positioning upside, as well as regulatory concerns around capital flow and investment in general, as the key risk points accumulating at the time across the broad HK/China equity space.

Incrementally additional developments over the past two weeks have further exacerbated the negative momentum:

- **Key reasons for the latest Hong Kong market drawdown -**

- Oct 22nd, the deadline for the tax payment based on the PRC individual income tax (IIT) on offshore trusts. The original announcement was made on July 24, 2026 by China's Ministry of Finance and State Taxation Administration (STA). The newly enforced regulations create a much more explicit tax framework for offshore trusts involving Chinese tax residents, taking effect immediately, with a 90-day window ending on October 22 for certain historical offshore-trust tax liabilities to be reported and paid without late-payment surcharges.

Even though we don't believe Oct 22's heavy selling was due to the urgency for subject entities/individuals to come up with cash for the tax settlement (any such selling would likely have been done much earlier on to meet the deadline), we do understand that the equity market overall may not be so familiar with the details of the development and the timeline sequence. Therefore, the market may have mistakenly thought this would trigger a round of panic selling.

(Continued in next section, with detailed market drawdown reasons, further downside potential, and A vs. H preference and rationale.)

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When could good value appear?

- The National Supervision Bureau summoned all major e-commerce players on Oct 21st and urged them to provide higher quality service and products, and to enhance/tighten their quality inspection mechanism. That triggered some concerns over potential pressure on margins for these players;

- The usual suspects - weakening domestic macro, uncertainty in the US and global market due to oil price, yield and inflation, and mid-term elections which could also impact Hong Kong meaningfully due the USD-HKD peg, and Hong Kong's unique nature of offering easier fund flow facilitation.

- **Key reasons for the latest A-share market drawdown -**

- Much stronger correlation between A-share market and the US market along the AI and capex super cycle investment themes. The A-share market has a much higher concentration of these segments (40%+ of CSI300), so the market tends to become more volatile if the US market becomes so;

- Extremely weak macro and consumption momentum. This is important as domestic investors, especially retail, still tend to trade by sentiment, on the "body-felt temperature" of macro activities. Therefore they can get nervous as macro data continues to weaken, despite the fact that the AI/Tech/Innovation sectors are doing much better with revenue and earnings growth (both ROE and earnings for CSI300 have gradually improved). Due to the weak macro, there is no place to rotate into if the AI/Tech narrative gets a bit challenged. This is different from the US market, where the S&P 500 may still be able to make a new high given much richer breadth and depth beyond the AI trade;

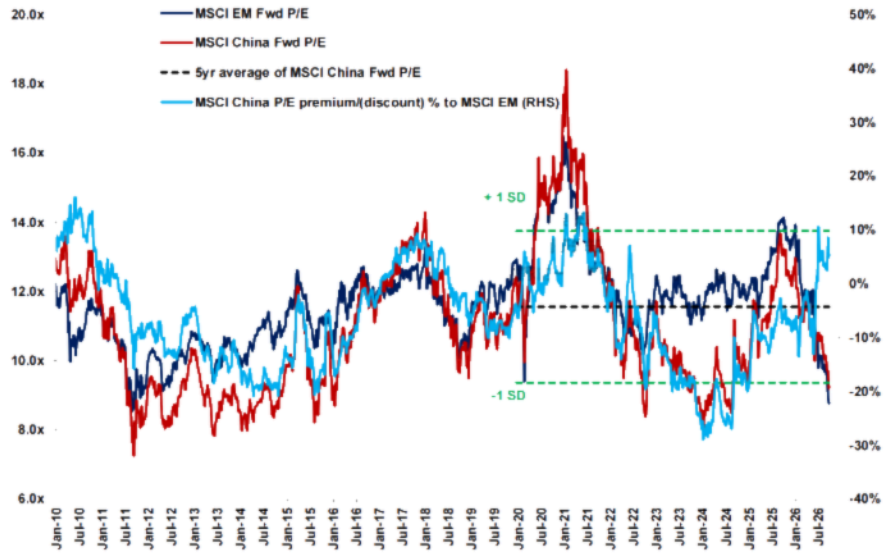
- Concerns about liquidity drying up due to upcoming mega IPOs, YMTC, etc.

Historical valuation range suggests further downside before troughing

For the offshore Hong Kong Hang Seng index and MSCI China -

The historical valuation range suggests another ~10-15% drawdown before hitting the trough level around 8x 12-forward P/E (this happened in 2008, 2015, early 2020, Oct 2022, and summer 2024). As discussed earlier, the Hong Kong market would also be subject to global bond yield volatility and Fed policy path.

Exhibit 1: MSCI China Fwd P/E vs. MSCI EM Fwd P/E

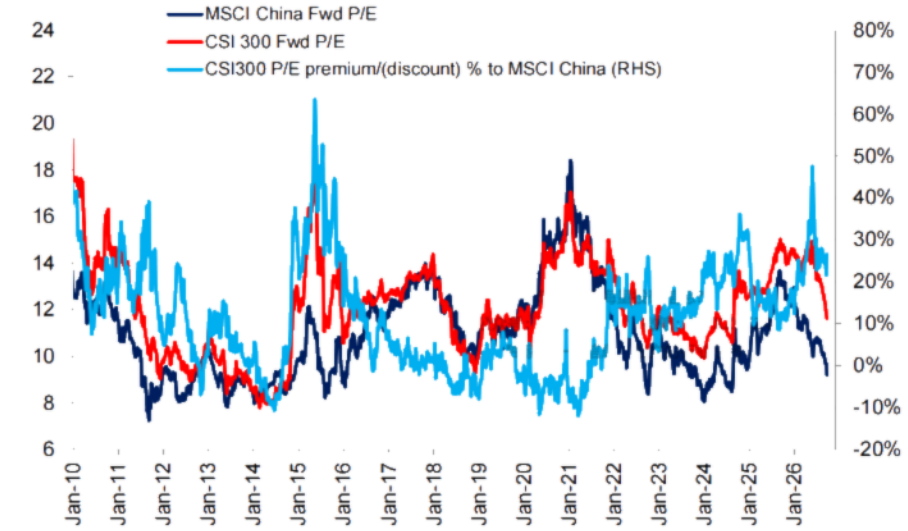


Source: Datastream, Morgan Stanley Research. Data as of Oct 22, 2026

For the A-share market -

A similar level of valuation de-rating has been experienced in the past for CSI300 before hitting its historical trough level at ~10-11x 12-month forward P/E (this had happened in late 2018, early 2020, late 2022, and 2024). We also believe it is more meaningful to monitor the National Team's actions and whether they change, as this could present an even stronger signal of near-term market stabilization. We provide a detailed discussion on this and the early signs of actions emerging in the next section.

Exhibit 2: CSI 300 Fwd P/E vs. MSCI China Fwd P/E



Source: Datastream, Morgan Stanley Research. Data as of Oct 22, 2026

Prefer A-shares on clearer National Team stabilization efforts

Clearer signs of onshore stabilization efforts including National Team

Stronger and clearer signal of Policy support finally appearing: One key reason for us to maintain a long-standing preference for the A-share market over the offshore space has been the stabilization capability offered by the National Team, along with A-shares' bigger concentration in the higher revenue and earnings growth segments in AI related, hard-core technology and innovation companies.

So for the A-share market, important to watch is when the National Team officially starts to buy in a high profile way. Based on historical experience, the market tends to trough and bottom out 1-2 months following high profile market purchases from the National Team, alongside open market communications from policy makers about commitment to stabilizing the equity market. We think that such actions are finally starting to appear in a meaningful and coordinated way, after an extensive period of National Team net selling since Jan 2026. We summarize them here:

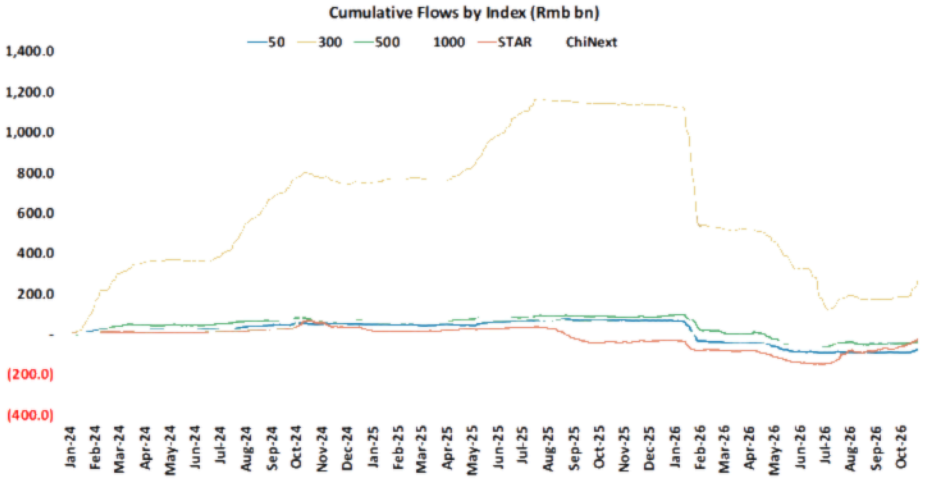
1) According to Bloomberg Intelligence, National Team-backed money bough US$15bn between Oct 9 - Oct 20. This reported figure is quite consistent with the broad-based CSI300 ETF flows we track and use as a proxy for National Team buying (Exhibit 4). What's worth noting even more is that the mix looks different from traditional stabilization episodes:

- CSI300: about 45% of estimated purchases versus ~60%-70% historically;
- STAR50 + ChiNext: ~37-50%, versus only ~7-17% historically.

That rotation is quite telling because the current drawdown has been concentrated in technology/growth. STAR50 had fallen nearly 40% from its peak amid the global AI/tech correction. Buying those ETFs rather than only heavyweight CSI300 ETFs looks more like a move to stabilize the epicentre of the selloff, rather than mechanically support the index.



Exhibit 3: Cumulative ETF flows of CSI 50/300/500/1000, STAR and ChiNext



Source: Datastream, Morgan Stanley Research. Data as of Oct 22, 2025

No investment recommendation is made with respect to any of the ETFs or mutual funds referenced herein. Investors should not rely on the information included in making investment decisions with respect to those funds.

Exhibit 4: Comparison of 2024 and 2026 national team stabilization efforts

(Rmb bn)	CSI 50	CSI 300	CSI 500	CSI 1000	STAR	ChiNext	Total
2024							
Jan 2, 2024 - July 21, 2025	71.1	1,164.5	93.1	116.0	37.3	77.3	1,559.3
% of Total	4.6%	74.7%	6.0%	7.4%	2.4%	5.0%	
June 19, 2024 - Oct 17, 2024	22.6	433.8	28.2	66.4	51.1	66.7	668.9
% of Total	3.4%	64.9%	4.2%	9.9%	7.6%	10.0%	
Sep 24, 2024 - July 21, 2025	23.4	439.3	29.1	54.0	9.1	40.4	595.4
% of Total	3.9%	73.8%	4.9%	9.1%	1.5%	6.8%	
2026							
July 6, 2026 -now	17.9	134.2	19.6	28.0	121.2	90.4	411.3
% of Total	4.3%	32.6%	4.8%	6.8%	29.5%	22.0%	
Oct 13, 2026 - now	16.7	77.4	5.7	4.1	27.8	33.9	165.6
% of Total	10.1%	46.7%	3.4%	2.5%	16.8%	20.5%	

Source: Datastream, Morgan Stanley Research. Data as of Oct 22, 2025

2) On Oct 15th, Beijing was reported to have asked state-backed funds and companies to: 1) buy equities; 2) called on the National Team to accelerate purchases; and 3) ask major insurers to report equity positions and avoid realizing losses on underwater positions. There has also been market discussion around window guidance being given to select institutional investors to restrain selling.

This suggests the buying isn't merely opportunistic by Huijin/state funds, and there is a coordinated policy intent to interrupt the negative feedback loop.

3) On Oct 19th, CSIRC Chairman Mr. Wu Qing reinforced the market stabilization message publicly in his October Financial Street Forum speech. He specifically said that the CSRC would -

- put stability first;
- strengthen and improve market-stabilization mechanisms;
- broaden the sources/channels for medium- and long-term money entering equities;
- deepen mutual-fund reform to enlarge the market's "stabilizing force";
- encourage qualified listed companies to increase buybacks and shareholder stake increases;
- approve the first 18 actively managed ETFs (going live on Oct 23rd), explicitly noting that they would introduce additional capital.

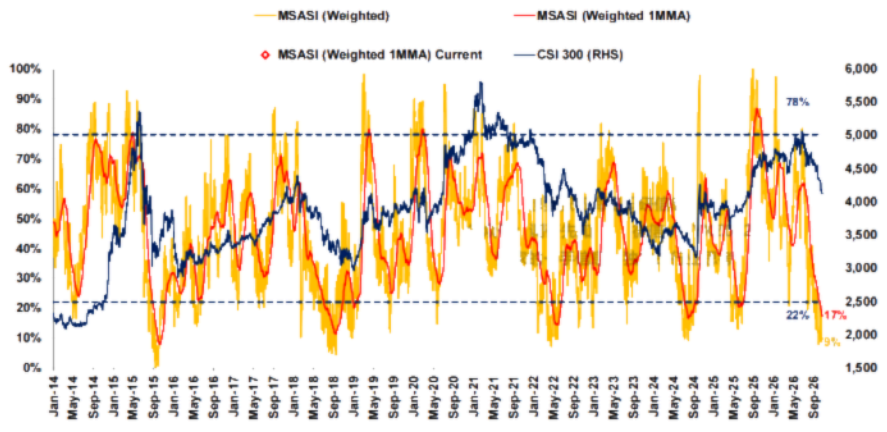
4) Corporate/state-sector buybacks are being mobilized as a second stabilization channel. National Team's market stabilization effort should not be taken as narrowly defined Central Huijin purchase activity. In fact, there is a broader architecture behind the "National Team" itself.

The well-known **Stock Buyback and Shareholding Increase Re-lending Facility** (originally launched in Oct 2024) now has much easier terms than when it was launched. Loan maturity has been extended from one to three years, required own-capital contribution reduced from 30% to 10%, and SOE capital-operation platforms have been made eligible. Since inception, A-share companies have applied for 1,113 buybacks/increased loans with a maximum value of ~Rmb233bn (out of the RMB300bn quota).

MS A-share sentiment hitting technical rebound threshold

Our Morgan Stanley proprietary A-share sentiment Index now sits below our technical rebound signal level at 22% for a month as of Oct 21 (Exhibit 5) (China Equity Strategy: A-Share Sentiment Remains Near July 2024 Levels for Third Week). Historically, more often than not, a meaningful index level rebound has been likely to follow within the next 1-2 months' time.

Exhibit 5: MS A-share Sentiment Indicator: MSASI weighted and MSASI weighted 1MMA



Source: CEIC, Bloomberg, Wind, RIMES, Morgan Stanley Research. Data as of Oct 21, 2026

In conclusion, we continue to prefer the onshore A-share market given its distinctive liquidity support from the National Team and other market stabilization efforts, while the rest of the world (including the Hong Kong market) could still be subject to geopolitical risks and macro/funding cost uncertainties.

So far, in our view, what has happened demonstrates that Beijing is currently trying to change the marginal supply/demand balance and establish a floor without brute-force intervention. This more proactive messaging and still ample dry powder (National Team sold over US$150bn in Jan - June), based on historical experience, suggests that stabilization of the A-share market could be more visible now, likely within another month or two, or so.