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China's Milestone Moment for Markets Now a Distant Memory (1)
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(Bloomberg) -- Sentiment toward China's frayed financial markets looks to be on its last legs with rebounds that don't last, inflows that don't stick and vows of more action from Beijing that keep falling flat.

For fund managers, that means facing the prospect of more losses in stocks, outflows from bonds, credit defaults and a weaker currency.

The muted reaction to China's fiscal stimulus plans and a surprise interest-rate cut last week exemplifies a trend that's been intensifying in recent months: Xi Jinping's government is increasingly powerless when it comes to reviving investor spirits.

Hope that dramatic interventions five months ago – dubbed by some as China's "Draghi" moment in a comparison to the 2012 European Central Bank president's promise to save the euro - has turned into skepticism over whether policymakers will do whatever it takes to bolster financial markets.

The MSCI China Index has slumped about 12% so far this quarter compared to an 8% gain in a global gauge of shares. That puts it on track for the worst quarterly performance on a relative basis since 1999 and comes just after Chinese shares outperformed by almost 20 percentage points in the second quarter.

"China is at a crossroads in terms of investor sentiment," said Francois Savary, chief investment officer at Prime Partners SA, which last week reduced its exposure to the country. "Will China be able to deal with its weaknesses? There's the fear that authorities have acted too little too late."

Of the at least 25 official pledges of support for the economy, markets or corporates since March 16 -- when China addressed investor concerns in a then-rare coordinated swoop -- only four have coincided with a 2%-plus gain in stocks. Analysts have been calling for more concrete steps since, but appear disappointed with measures including liquidity for property firms, mortgage rate cuts and lower borrowing costs.

On Monday, stocks fell and the offshore yuan weakened to an almost two-year low even as authorities planned more liquidity support for developers and Chinese banks reduced their benchmark lending rates.

Faced with a choice between endless uncertainty and the belief a recovery will soon take hold, investors are leaning toward the former. Foreigners have pulled money from China's capital markets for six straight months and outflows hit a record in March. Risks have become so unquantifiable that some, like Boston based Zevin Asset Management, are walking away. "China's economic dream has more or less come true and now politicians are focusing on all the repercussions that come with that," said Sonia Kowal, president at ZAM, which recently sold all its Chinese and Hong Kong holdings. “We would consider getting back into China in the future when the country finds itself on a more sustainable path.”

Still, while steadying market sentiment may be the goal, Beijing won’t want to go too far and risk engineering a speculative bull run. China experienced two massive bubbles since the global financial crisis and talking up the markets is a dangerous game in a country where investment choice is limited due to capital controls.

Yi Huiman, who leads the country’s securities regulator, vowed this month to keep capital markets stable but said intervening in a functioning stock market wasn’t suitable.

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Can things get worse for China’s markets if officials stick to the current strategy? The stakes are high, according to Wee Khoon Chong, a senior market strategist at Bank of New York Mellon in Hong Kong, who says the relationship between policy directives and asset prices in China is broken.

“Confidence, in markets and among consumers, is critical to maintaining financial stability,” he said. “We therefore see no room for complacency and, indeed, see restoring confidence as a matter of urgency.”

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