

| China

China Strategy

Perfect storm: confluence of bear factors?

- The recent correction in the HK market is due to various negative factors, such as increasing concerns about global liquidity risk (partly due to geopolitical issues), the recent COVID-19 situation (in China and HK), and potential US sanctions on Chinese companies.
- The HSI is a global underperformer on a YTD and MTD basis.
- The market is expected to remain volatile given geopolitical issues, concerns about global liquidity movement, and a potential downward revision in net profit forecasts. However, the easing of some global liquidity indicators may support a further rebound after today's strong performance. Also, the pro-growth policy of the Chinese government is expected to provide support for Chinese companies and the HK market.
- The analysis in this report is based on industry and macro figures and may differ from the views of individual analysts, in some cases.

YTD Hong Kong is a global underperformer

The HSI dropped 14.9% in 2021, underperforming other major global stock indexes. This is mainly due to the weak performance of the TMT and education sectors, given stricter industry regulations by the authorities. The HSI has reported a YTD return of -15.5% in 2022. The index hit 18,235 (-22.1% YTD) on 15 Mar 2022, the lowest level since Jun 2012, dragged down by intensifying geopolitical tension and weak market sentiment on Chinese equities (tripped by a sell-off of ADRs). Average daily turnover (ADT) of the Hong Kong market increased 29% yoy to HK\$166.7bn in 2021. In 2M22, ADT dropped 46.1% to HK\$129.4bn. The drop in trading liquidity makes the HK market more volatile because of higher selling pressure. On a month-to-date (MTD) basis, all HSI sub-indexes reported a decline, and Biotech, TMT and Consumption underperformed. On a MTD basis, the HSI, HSITECH and HSCEI are underperformers on a global basis. The recent sharp correction in the HK market was due to various negative factors such as increasing concerns about global liquidity risk (partly due to geopolitical issues), the recent COVID-19 situation (China and HK), and potential US sanctions on Chinese companies.

Easing of global liquidity indicators may support improved performance

The HSI is one of the major underperformers globally. Technically, it dropped below a very long-term support level for the first time since 1980. The HSI is trading at 8x historical PER, which is the lowest ever on a three-year basis. The HSI Connect A/H Premium Index indicates that H-shares are trading at the highest discount to A-shares since mid-2016. In terms of valuations, the HK market is one of the lowest. Regarding global liquidity movement, the Liquidity Risk indicator and MOVE Index (Merrill Lynch Option Volatility Estimate) eased from their peak last week. The HK aggregate balance may indicate a lower liquidity level in the HK market than the peak in 2021, but this is a gradual process, and this wasn't a short fall. Despite weak market sentiment, southbound money (through the Stock Connect program) remains a net buyer in the Hong Kong market. In term of short-selling activity in the HK market, the outstanding amount has remained at a high level since the beginning of 2017.

New news flow on ADRs and overseas listings of Chinese companies

There are concerns about whether ADRs, as an asset basis, will become a victim of increasing tension between China and the US, especially after five ADRs were named by the SEC as non-compliant on the auditing rules and are subject to de-listing. In our view, the concerns have been amplified by sanctions on Russian companies. This situation is not new, and delisting may be inevitable if the companies are non-compliant on the auditing rules for three years (with 2021 as the starting point, compliant audited results will available only in 2024). There are various ways to deal with the SEC's rules. We reiterate that in general, the listing location doesn't have any impact on the business outlook, but it may impact valuations, given the exposure of different investors. We note news flow on this topic in both China and US, and the tone indicates expected co-operation between the two side to come up with a solution. This is expected to provide a short-term boost to ADRs.

A further rebound after strong performance today

The market is expected to remain volatile, given geopolitical issues, concerns about global liquidity movement, and a potential downward revision in net profit forecasts. However, the rebound today may indicate the market has found a near-term trough. Potential short-covering activity may boost the rebound after today's rally. The pro-growth policy of the Chinese government is also expected to provide support to Chinese companies and the HK market. The major TMT platforms are expected to benefit from easing of concerns. We prefer Biotech companies with a strong R&D pipeline and exposure to the COVID-19 vaccine and treatment segment. Equipment and industrial commodities are expected to benefit from a pro-growth policy.

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Figure 1: The Hang Seng Index has underperformed major global indexes since 2021

Stock indexes	% change in 2021	Stock indexes	% change ytd (as of Mar 15, 2022)
U.S. market		U.S. market	
Dow Jones Industrial Average	19.69%	Dow Jones Industrial Average	-9.5%
S&P 500	28.05%	S&P 500	-12.7%
NASDAQ Composite	22.31%	NASDAQ Composite	-20.1%
EMEA		EMEA	
Euro STOXX 50	20.56%	Euro STOXX 50	-13.1%
FTSE 100	12.92%	FTSE 100	-2.8%
CAC 40	28.11%	CAC 40	-11.2%
DAX	15.79%	DAX	-15.4%
Asian markets		Asian markets	
Hang Seng Index	-14.86%	Hang Seng Index	-15.5%
Nikkei 225	4.91%	Nikkei 225	-12.1%
CSI 300	-3.76%	CSI 300	-15.2%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

Figure 2: Hang Seng Index sector performance since 2021

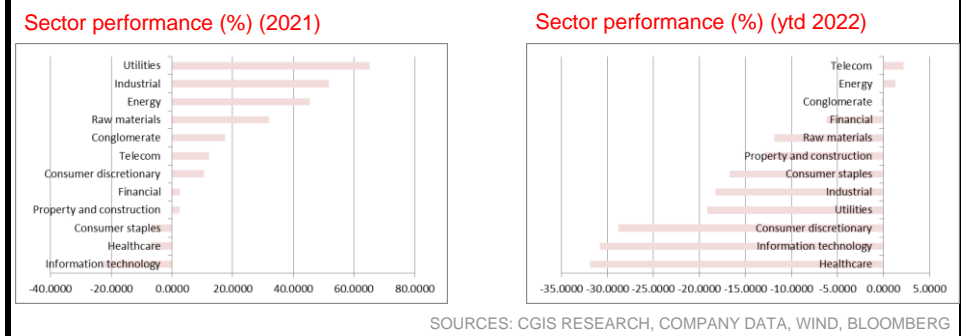


Figure 3: The Hong Kong market as an asset class is a global underperformer

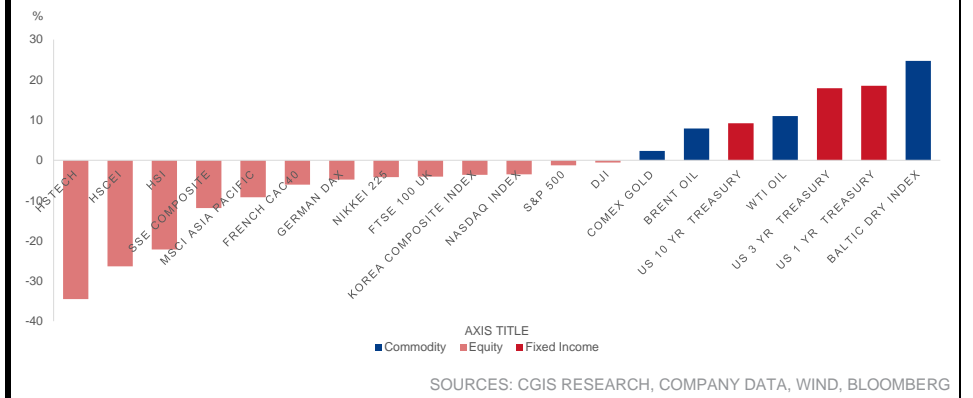


Figure 1: HSI broke through the long-term support level for the first time since 1980

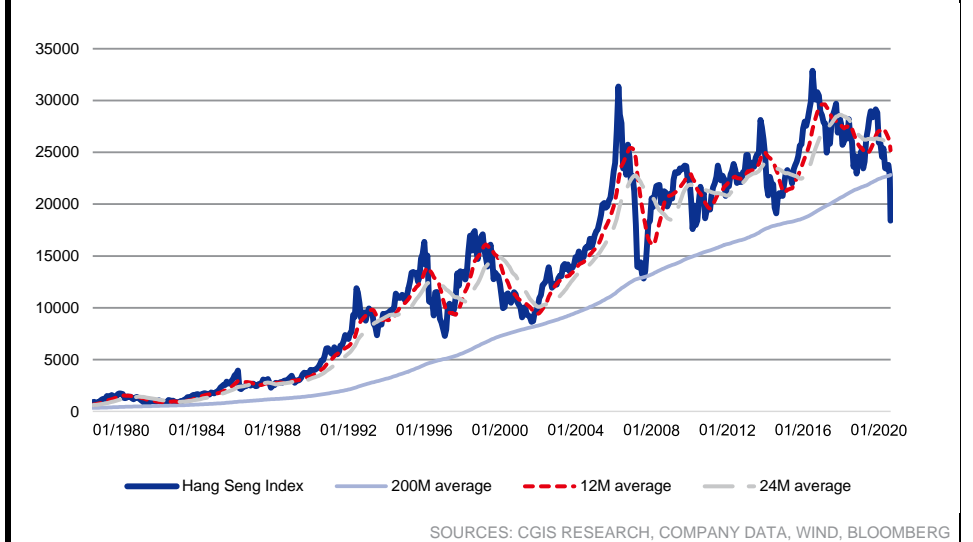
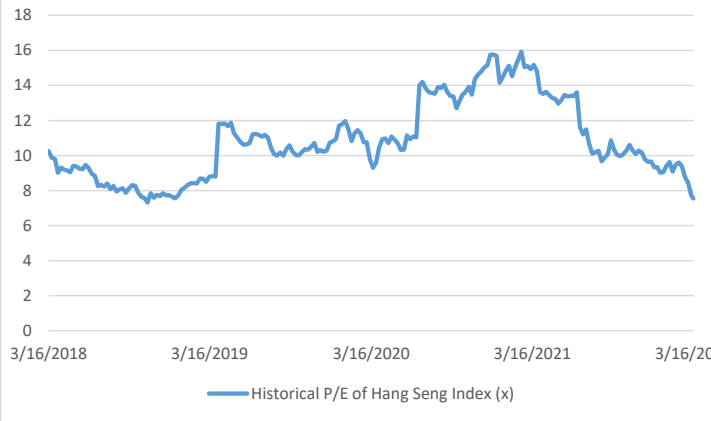


Figure 5: HSI – Historical P/E (X)



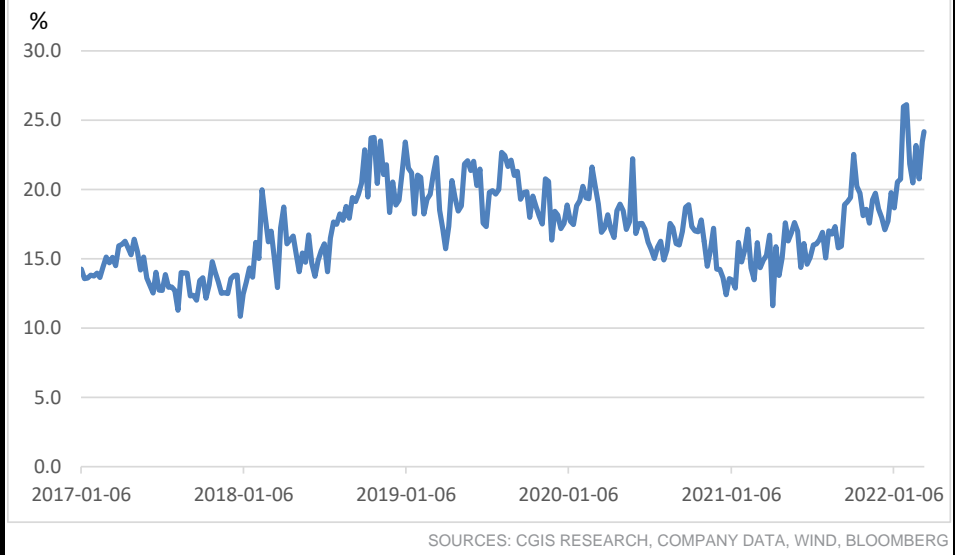
SOURCES: CGIS RESEARCH, COMPANY DATA, WIND, BLOOMBERG

Figure 6: H-shares trading at highest-ever discount to A-shares



SOURCES: CGIS RESEARCH, COMPANY DATA, WIND, BLOOMBERG

Figure 7: Outstanding short selling positions at a high level



SOURCES: CGIS RESEARCH, COMPANY DATA, WIND, BLOOMBERG

Figure 8: US Financial Condition Index



SOURCES: CGIS RESEARCH, COMPANY DATA, WIND, BLOOMBERG

Figure 9: USD Liquidity Risk Index



Figure 10: ICE BofA MOVE Index



Figure 11: Hong Kong aggregate balance

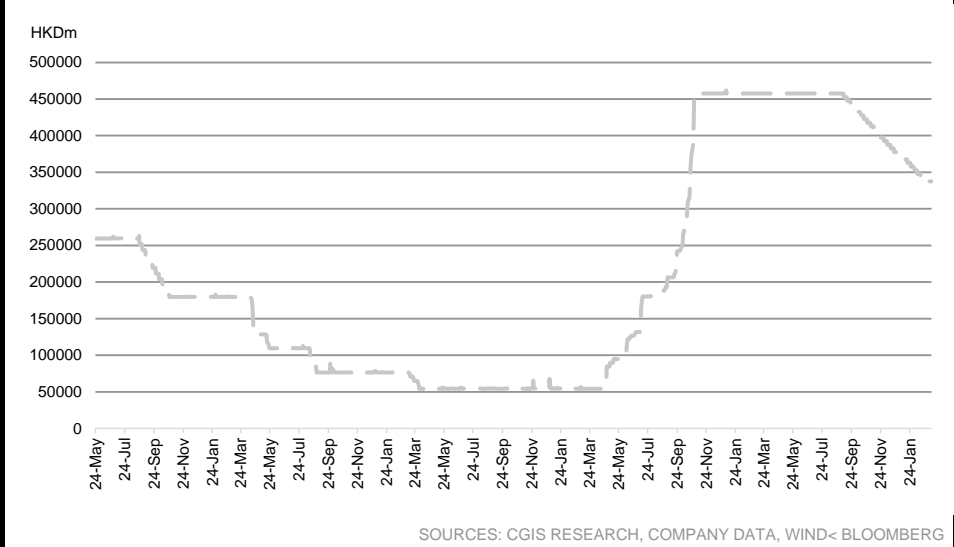
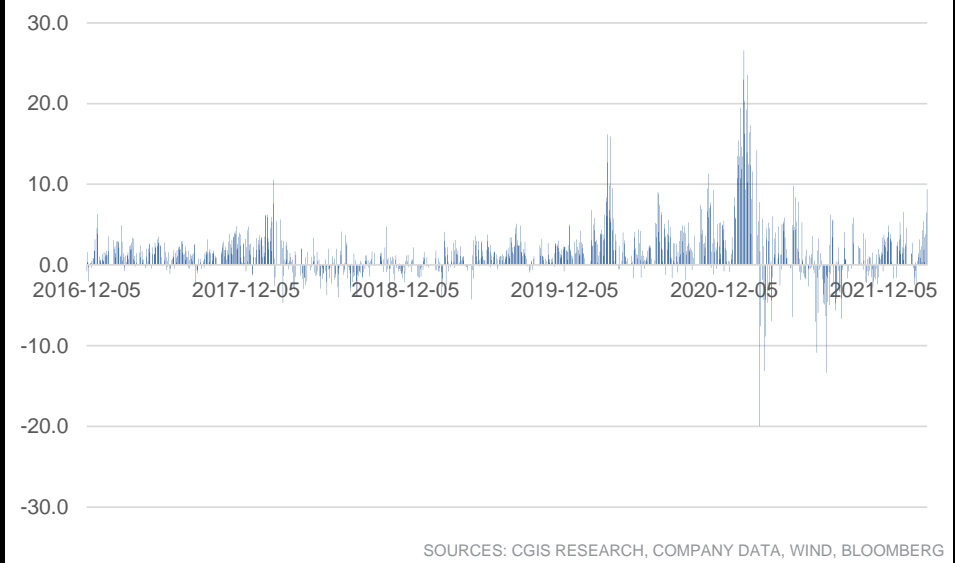


Figure 12: Stock Connect southbound net buy amount (HK\$ bn)



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Distribution of stock ratings and investment banking clients for quarter ended on 31 Dec 2021		
619 companies under coverage for quarter ended on 31 Dec 2021		
	Rating Distribution (%)	Investment Banking clients (%)
Add	71.1%	1.5%
Hold	21.8%	0.0%
Reduce	7.1%	0.0%

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Add	The stock's total return is expected to reach 15% or higher over the next 12 months.
Hold	The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
Reduce	The stock's total return is expected to fall below negative 10% over the next 12 months.

The total expected return of a stock is defined as the sum of the:(i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

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Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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