STRATEGY – GREATER CHINA

What Is In The Price?

Even with the oversold rebound on 16 Mar 22, Chinese equities are still trading at an attractive 10.9x 12-month forward PE. We expect further legs to the rally in 2Q22, driven by easing of COVID-19 restrictions and kicking in of reflationary policies. We recommend going long on benchmark blue chips and beneficiaries of policy easing; sector-wise, these would be internet, commodities and renewables. Sustained high commodity prices and further US sanctions are the key risks in 2H22.

WHAT'S NEW?

- **Confidence booster as China looks to domestic growth.** Vice Premier Liu waved off expectations on macro policy stance, property risks, American Depositary Receipts (ADR) and platform company regulations on 16 Mar 22. Although there have been delays in earlier reflationary efforts, we expect an immediate push to ramp up domestic growth, in view of the rising external headwinds. Various announcements of property sector policy relaxation, news of China exploring ways it can "live with COVID-19" and President Xi highlighting the need to minimise the impact of COVID-19 on the economy and society point to a greater urgency to safeguard the growth momentum.

- **Energy and commodity prices will remain elevated** with the Russia-Ukraine war and the ensuing sanctions on Russia and her counter sanctions triggering fears of a supply crunch. Current prices of commodities like aluminium, nickel, palladium and oil are much higher than in end-21, and will likely stay elevated even if a peace deal is reached in the near term. Brent crude oil rose by as much as two-thirds recently to US$105.90/bbl from its level at the beginning of the year, while natural gas and wheat prices more than doubled before easing slightly. With Russia and Ukraine being major commodity and grain exporters, there is a significant risk to global growth in 2H22.

- **Outstanding risks.** China may also face additional pressure from the West for its refusal to sanction Russia. Moreover, the Phase 1 trade deal with the US is up for review and given that China has not fulfilled her commitments over the past two years, it is very likely that further punitive measures will be imposed by the US. Domestically, the recent policy reset on China's internet sector may see further refinements that may surprise markets, but we see the risk on this front receding.

- **Reinforcing trend towards deglobalisation.** The recent geopolitical events and disruptions to the global supply chain due to COVID-19 restrictions have reinforced the trend towards decoupling and deglobalistion. China would have to double her efforts in lifting domestic demand, continue with supply-side reform and eventually resolve her debt leverage. In the near term, we expect China to prioritise energy security as reiterated during the Two Sessions meeting, and take a more pragmatic approach to the long-term carbon neutrality goal.

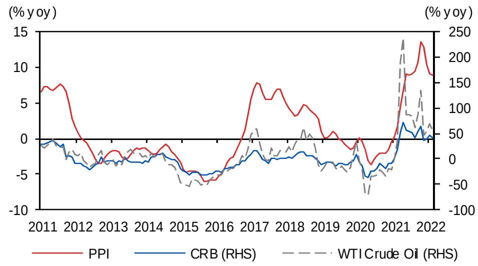
- **Strategy.** Markets are likely to stay volatile due to external factors but we opine that there are further legs to the relief rally with the easing of COVID-19-related restrictions, further rollout of reflationary polices and hopefully a peace deal between Russia and Ukraine. We opine that China's CPI inflation will not be significantly impacted by the wild swings in oil prices, given its energy price-setting mechanisms, but the manufacturing sector will face renewed margins pressure due to a more sensitive PPI.

- With valuations still at attractive levels, we recommend sticking to the benchmark big caps and buying into domestically focused themes with minimal exposure to Europe, and less sensitive to commodity price hikes. Our key stock picks are: Alibaba (9988 HK), BYD (1211 HK), Contemporary Amperex Technology (300750 CH), CIFI Holdings (884 HK), China Resources Beer (291 HK), Ganfeng Lithium (1772 HK), HKEX (388 HK), JD.com (9618 HK), Li Ning (2331 HK), Meituan (3690 HK), Tencent Holdings (700 HK), Wuliangye (000858 CH) and Xinyi Solar (968 HK).

- Looking ahead, China would have to double down on her efforts in lifting domestic demand, and continue with supply-side reform which could eventually help resolve the over-reliance on debt-fuelled growth. But those changes could also mean several lean years in the offing.

Click here for Blue Top dated 6 Apr 22

PPI MORE SENSITVE TO WTI



Source: Bloomberg, WIND, UOB Kay Hian

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- For now, despite some nagging concerns, we believe current valuations have priced in most negatives related to COVID-19 disruptions and policy risks on tech giants, as well as slowing Chinese growth. Other issues like the pace of global growth in 2H22 can only be properly assessed over the next 2-3 months as sanctions on Russia may be increased further. Besides, the Fed may also reassess the pace of rate hikes if US growth eases more than expected. The GDP nowcast from Atlanta Fed is close to zero and should be closely monitored.

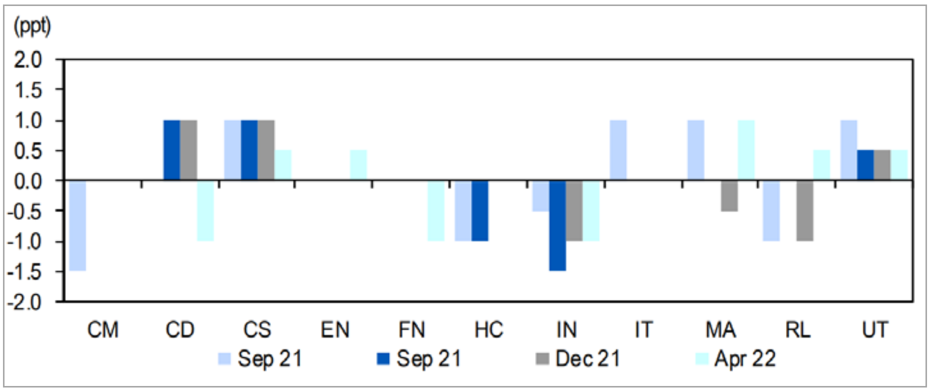
- Thus, we opine that on balance Chinese equities should trade higher in April and May, as the easing of COVID-19-related restrictions and further rollout of reflationary polices boost sentiment. A ceasefire or peace deal between Russia and Ukraine would provide further lift. While another sharp rebound in the near term is unlikely, many assets have already priced in a negative outcome with valuations still at attractive levels, which should provide significant scope for shares to rally. The next question is, what should investors buy?

  - From a technical standpoint, stick to the benchmark big caps as the index would not rebound without the participation of big caps.
  - Sectors that are domestically-focused and likely to benefit from policy reflation and property sector policy relaxation. The government has reiterated their push for FAI and renewable energy during the Two Sessions meeting. We would also expect further policy relaxation for the property sector.
  - Stocks with low risk of sanctions by the West.
  - Minimal exposure to Europe

ACTION

- Sector-wise, we have recently raised the real estate sector to OVERWEIGHT and given our view on sustained higher commodity prices, we are also increasing the allocation to energy and materials, at the expense of consumer discretionary, consumer staples and financials.

SECTOR ALLOCATION



Source: UOB Kay Hian

PEER COMPARISON

Sector	Bloomberg Ticker	Company	Current Price (lcy)	Target Price (lcy)	Upside To TP (%)	PE 2022F (x)	PE 2023F (x)	Dividend Yield 2022F (%)
BUYs								
Consumer Discretionary	9988 HK	Alibaba	113.70	130.00	14.3	14.6	11.8	0
Consumer Discretionary	1211 HK	BYD	243.60	350.00	43.7	82.4	58.9	7.1
Consumer Discretionary	9618 HK	JD.com	246.6	339.00	37.5	32.2	21.9	3.8
Consumer Discretionary	2331 HK	Li Ning	67.15	113.42	68.9	29.4	23.7	1.06
Consumer Discretionary	3690 HK	Meituan	167.00	207.00	24.00	n.m	84.1	0
Communication Services	700 HK	Tencent	390.00	502.00	28.7	24.6	19.8	0.5
Consumer Staples	291 HK	CR Beer	48.70	78.30	60.8	28.9	22.9	1.4
Consumer Staples	000858 HK	Wuliangye	159.90*	325.00	103.3	21.4	18.3	2.3
Financials	388 HK	HKEX	370.80	510.20	37.6	37.5	33.4	2.6
Industrials	300750 CH	CATL	518.90*	1,000.00	92.7	62.8	41.3	13.0
Materials	1772 HK	Ganfeng Lithium	114.80	262.00	128.2	14.2	10.4	35.8
Real Estate	884 HK	CIFI Holdings	4.61	6.27	36.0	3.4	3.1	10.3
Utilities	968 HK	Xinyi Solar	13.86	16.50	19.0	23.9	16.8	3.7

Note: Prices as of 4 Apr 22
** Price as of 1 Apr 22*
Source: Bloomberg, UOB Kay Hian

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