April Monthly Strategy

Style shift to take a break

Last month we had a strong preference for cyclicals over growth stocks, but now we expect less contrasting performance in value and growth stocks in coming weeks, because 1) investors are getting used to rise in bond yields; 2) value stocks' momentum is weakening; and 3) growth stocks have become less frothy.

- **Stocks becoming less sensitive to rising bond yields.** The surge in bond yields triggered sell-offs in global equity markets since mid-Feb, but correlation between stocks and bond yields has returned to slightly positive. The rise in bond yields may even take a break, giving a breather to stocks.
- **Earning season review: cyclicals beat.** FY20 annual result season in HK has been a bit disappointing, with FY21E consensus earnings revised down. By sector, cyclicals, particularly financials, brought more positive surprise, while growth stocks such as internet, consumer and healthcare missed.
- **Fund flows: Southbound buying remained weak.** Southbound buying via Stock Connect has been a major driving force behind the 15% rally in the HSI and 31% rally in the HSTECH earlier this year, but inflows have significantly weakened since mid-Feb. A slump in mutual funds issuance in Mainland China certainly does not help Southbound flows.
- **Technical Analysis: growth bottoming out; value overbought.** The HSI is at a crossroads, waiting for a breakout of a downward channel. The HSTECH is forming a bullish "double bottom". By style, value stocks are relatively overbought against growth stocks.
- **Rotation to value nearing an end?** The daily Relative Rotation Graph (RRG) of the HSCI shows that value sectors are weakening while growth stocks are improving in momentum, which implies this round of sector rotation may be nearing an end.
- **Strategy: stock picking is now the key.** Favour industry leaders with either 1) better-than-expected FY20 result; 2) promising 1Q21E guidance; 3) upside in consensus earnings; or 4) cheap valuation with turnaround story.

Preferred industry leaders

Sector	Company
Internet	Kuaishou (1024 HK)
Technology	Sunny Optical (2382 HK), BYD Electronics (285 HK), ZTE (763 HK)
Capital Goods	Zoomlion (1157 HK / 000157 CH)
Consumer	WH Group (288 HK)

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Market Data

Hang Seng Index	28,378
52-week High / Low	31,183/22,520
3-month avg. daily t/o	HK$223.7bn

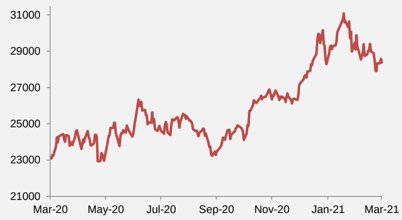
Source: Bloomberg

Indices Performance

	HSI	HSCEI
1-month	-3.6%	-4.2%
3-month	4.2%	2.2%
6-month	21.0%	16.8%

Source: Bloomberg

12-month HSI Performance



Source: Bloomberg

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1. Strategy Report – Don't panic over rising bond yield – 3 Mar 2021
2. Strategy Report – HSI enhancement preview – 24 Feb 2021
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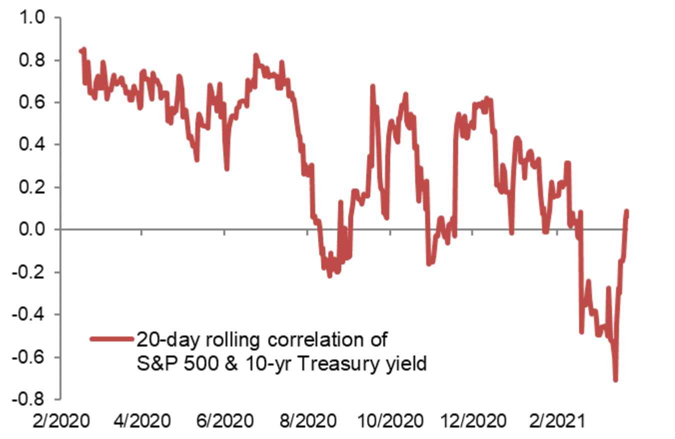
Stocks becoming less sensitive to rising bond yields

Stock price and bond yield return to positive correlation

The surge in bond yields have sent shockwaves across global equity markets since mid-Feb. While U.S. bond yields remained in uptrend in the past few weeks, stocks have become less sensitive to changes in bond yields, compared to what happened during mid-Feb to mid-Mar.

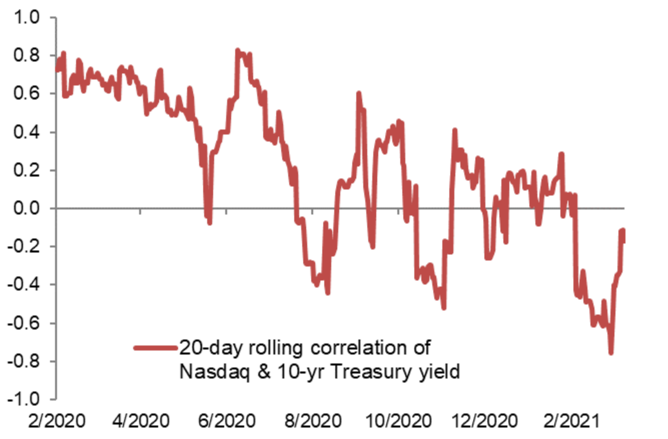
The rolling correlation between S&P 500 and U.S. 10-year Treasury yield has returned to slightly positive (Fig. 1). NASDAQ Composite's rolling correlation with 10-year yield is still negative, but with much smaller magnitude than a few weeks ago (Fig. 2). This shows that even high-valuation growth stocks, which are more vulnerable to rise in discount rates, is becoming less sensitive to bond yields.

Figure 1: Correlation of S&P 500 & Treasury yield



Source: Bloomberg, CMBIS

Figure 2: Correlation of NASDAQ & Treasury yield



Source: Bloomberg, CMBIS

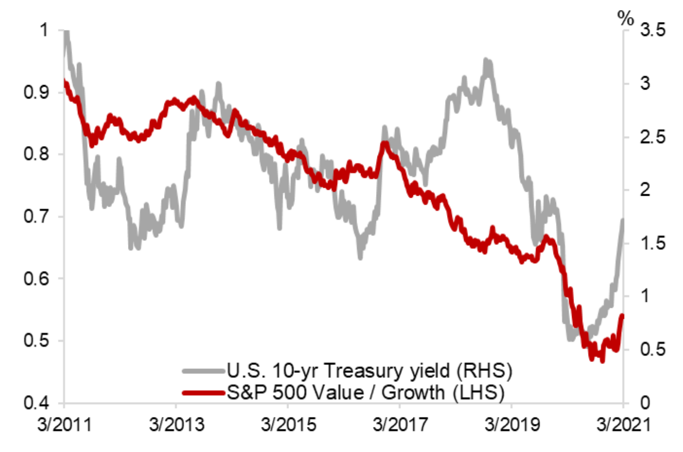
Value stocks should outperform if bond yield rises further

What if bond yields do rise drastically again? In that case, stocks in general may become under pressure once more, but not every sector would react equally badly. Value / cyclical stocks typically outperformed growth stocks when bond yields were rising (Fig. 3).

Rise in bond yields may take a break

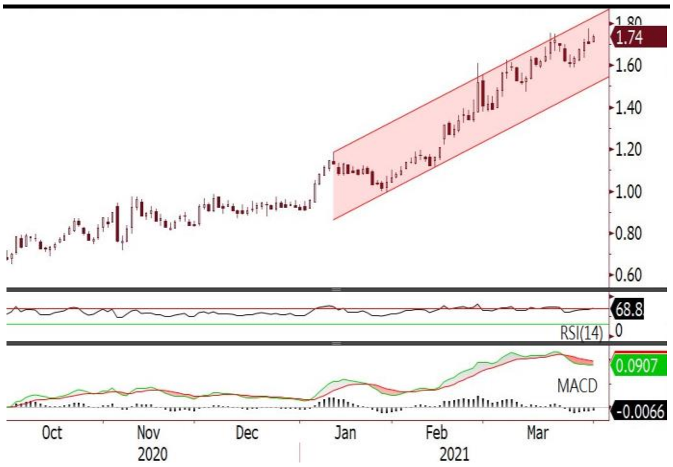
Besides, technically analysis, in our view, suggests the rise in bond yields may take a break. Fig. 4 shows that U.S. 10-year Treasury yield formed an uptrend since early Jan. With the yield close to the top of the uptrend, its pace of rise should moderate. Yield has even formed a bearish "RSI divergence", which suggests yield could pull back in the short term.

Figure 3: Value stocks outperformed in rising yield



Source: Bloomberg, CMBIS

Figure 4: U.S. 10-yr yield near top of uptrend



Source: Bloomberg, CMBIS

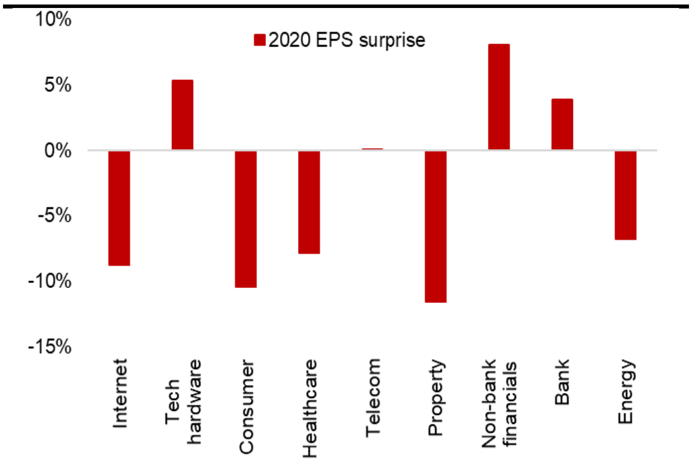
Earning season review: Cyclicals beat

FY20 annual result season in Hong Kong market has just been over. Overall speaking, earnings have been a bit disappointing, with FY21E consensus earnings being revised downwards.

By sector / style, cyclical / value stocks, particularly financials, brought more positive surprise in FY20 earnings. On the contrary, growth stocks such as internet, consumer and healthcare missed (Fig. 5).

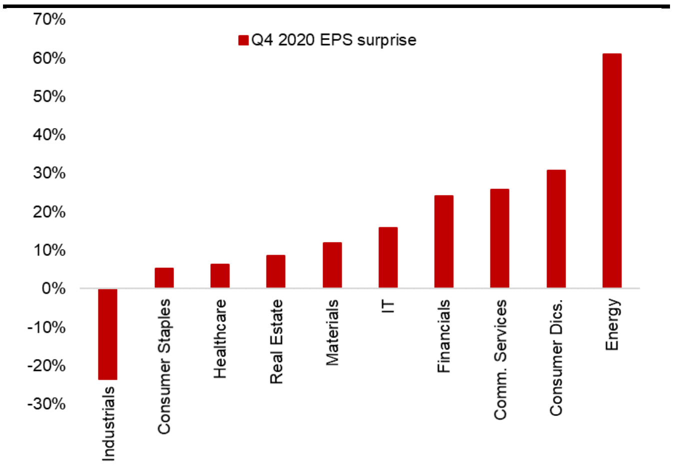
Such contrasting results by cyclicals and growth have been more obvious in the U.S. stock market. While Q4 2020 earnings beat in general, cyclicals (energy, financials, consumer discretionary) were by far more outstanding. Growth sectors such as IT, healthcare and consumer staples beat by much smaller margins (Fig. 6).

Figure 5: HSI FY20 earnings surprise by sector



Source: Bloomberg, CMBIS
As of 30 Mar 2021; only include companies with year-end on 31 Dec

Figure 6: S&P 500 Q4 2020 earnings surprise

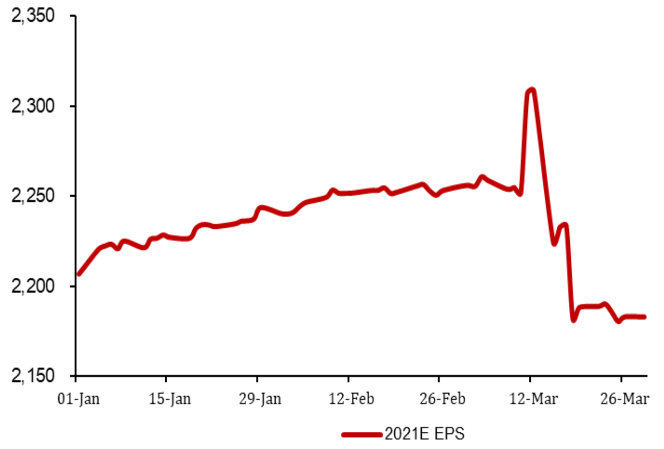


Source: FactSet, CMBIS

HSI EPS revised down, especially on growth stocks

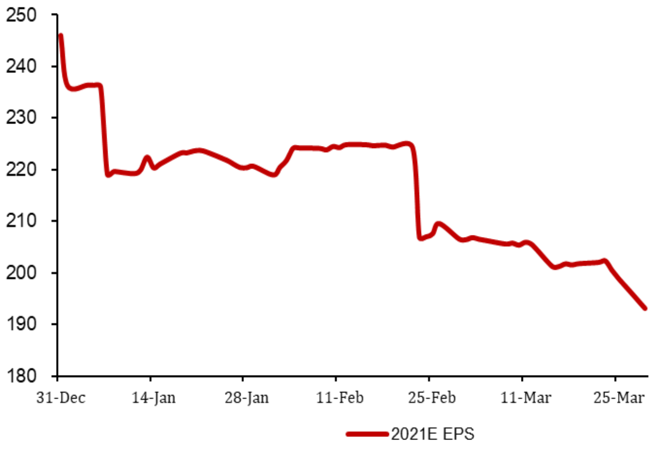
After results, consensus earnings of Hong Kong broad market have been revised downwards. In Mar, FY21E EPS of the HSI was cut by 3.2%, while that of the Hang Seng TECH (HSTECH) Index was slashed by 8.3% (Fig. 7 & 8).

Figure 7: HSI 2021E EPS -3.2% in Mar



Source: Bloomberg, CMBIS

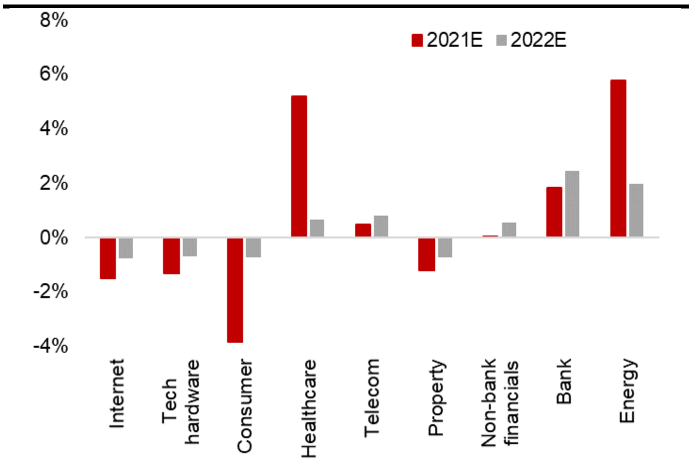
Figure 8: Hang Seng TECH 2021E EPS -8.3% in Mar



Source: Bloomberg, CMBIS

By sector, cyclical stocks in the HSI (financials and energy) enjoy upward revisions in consensus earnings, while growth stocks (except healthcare) got earnings cut (Fig. 9).

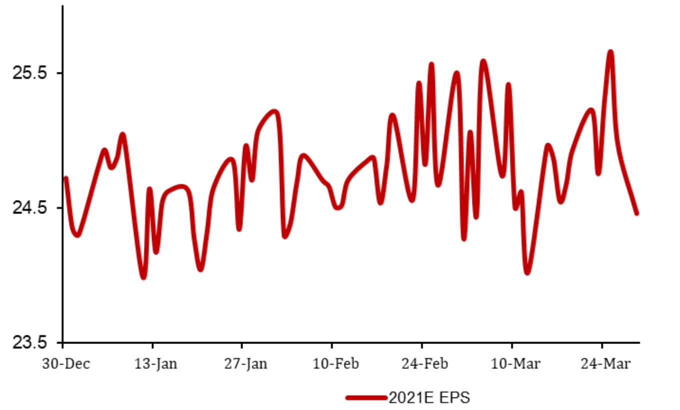
Figure 9: HSI stocks' post-result earnings revision



Source: Bloomberg, CMBIS
As of 30 Mar 2021; only include companies with year-end on 31 Dec. Excluded Meituan (3690 HK) as its FY21E EPS was revised from positive to negative.

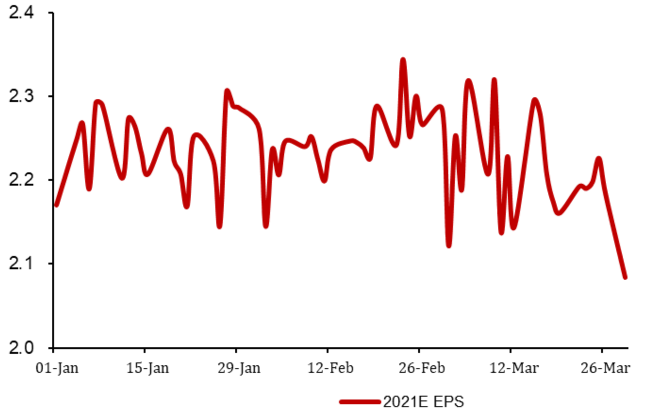
Similarly, MSCI China suffered downward earnings revisions in Mar, with much larger cuts in growth stocks (-8.0%) than value stocks (-0.8%) (Fig. 10 & 11).

Figure 10: MSCI China Value 2021E EPS -0.8% in Mar



Source: Bloomberg, CMBIS

Figure 11: MSCI China Growth 2021E EPS -8.0% in Mar

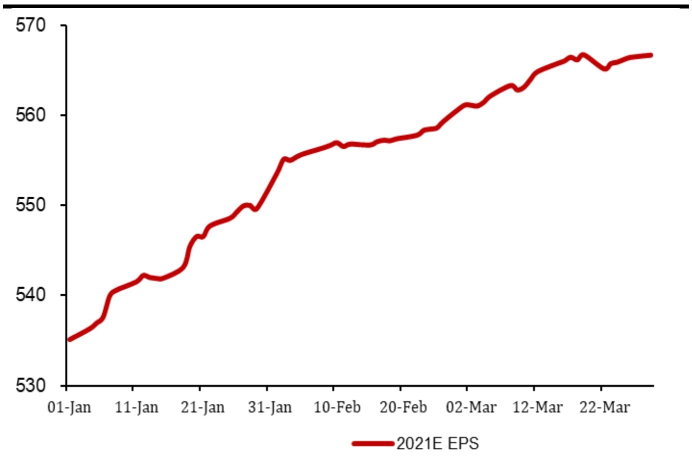


Source: Bloomberg, CMBIS

U.S. value stocks enjoyed better earnings revision than growth stocks too

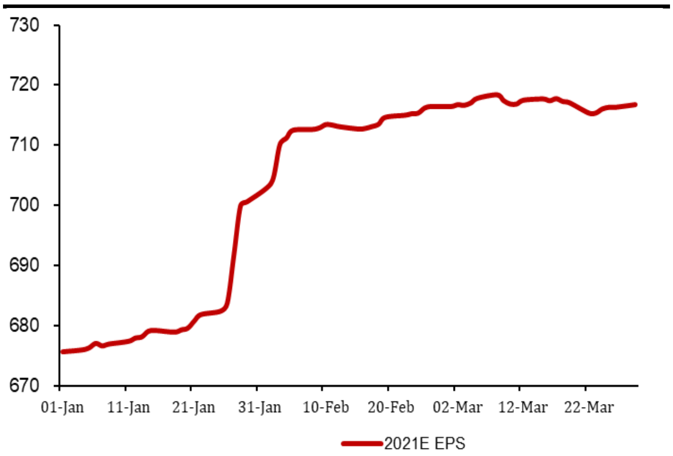
By comparison, the U.S. market had a more upbeat earnings season, with consensus earnings slightly revised upwards. Again, value stocks enjoyed better earnings revisions (+1.3%) than growth (flat) (Fig. 12 & 13).

Figure 12: S&P 500 Value 2021E EPS +1.3% in Mar



Source: Bloomberg, CMBIS

Figure 13: S&P 500 Growth 2021E EPS +0% in Mar



Source: Bloomberg, CMBIS

Fund flows: Southbound buying remained weak

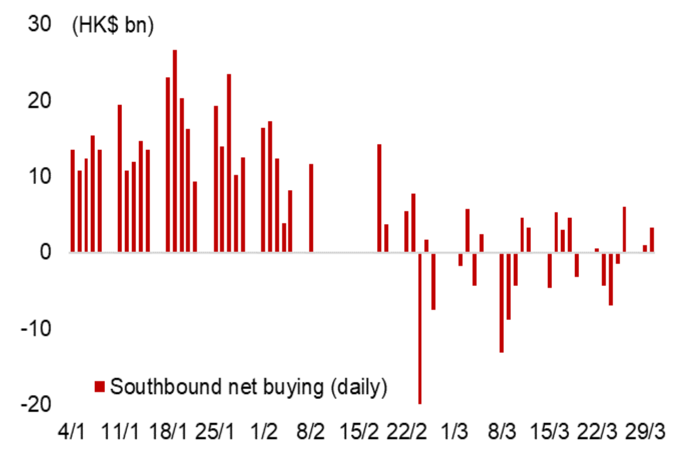
Recall that during early-Jan to mid-Feb, Southbound buying via Stock Connect has been a major driving force behind the 15% rally in the HSI. Tech stocks were chased by Mainland investors, driving up the HSTECH by as much as 31% in the same period.

But then, the topping out of Hong Kong market coincided with the remarkable drop in Southbound net buying. Despite the HSTECH retreating by 25% to reach negative territory YTD, lower valuations apparently failed to attract Mainland money to return (Fig. 14).

Onshore mutual funds issuance cooled

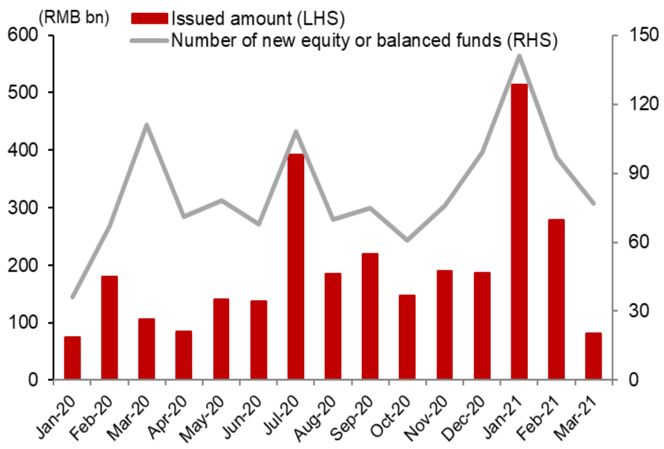
The drop in Southbound buying can be partly explained by the drop in mutual funds issuance in Mainland China. In Jan and Feb 2021, there were a sea of new mutual funds being issued, and many of them can invest a part of their AUMs in HK stocks via Stock Connect. But in Mar, new issuance amount dropped to the lowest level in at least a year (Fig. 15).

Figure 14: Daily Southbound Net Buying in 2021



Source: WIND, CMBIS

Figure 15: Onshore mutual funds issuance waning



Source: WIND, CMBIS

Technical Analysis

HSI at a crossroads

The HSI has formed a bearish “head-and-shoulders” pattern, and did drop below the neckline on 24-25 Mar, but then rebounded and is now right at the neckline. At the same time, the HSI has formed a downward channel (Fig. 16).

If the HSI can stay above the neckline 28,300 and break through the downward channel (currently at around 28,800), that may signal the end of correction.

HSTECH “double bottom”

The Hang Seng TECH Index had a much deeper correction (30% from peak) than the HSI (12%), and could be out of the woods earlier. While the HSTECH has obviously dropped below the neckline of “head-and-shoulders”, it has formed a bullish “double bottom” in Mar. A breakout at neckline 8,819 could signal an end to this correction.

Figure 16: HSI “head-and-shoulders” & downtrend

Source: Bloomberg, CMBIS

Figure 17: Hang Seng TECH “double bottom”

Source: Bloomberg, CMBIS

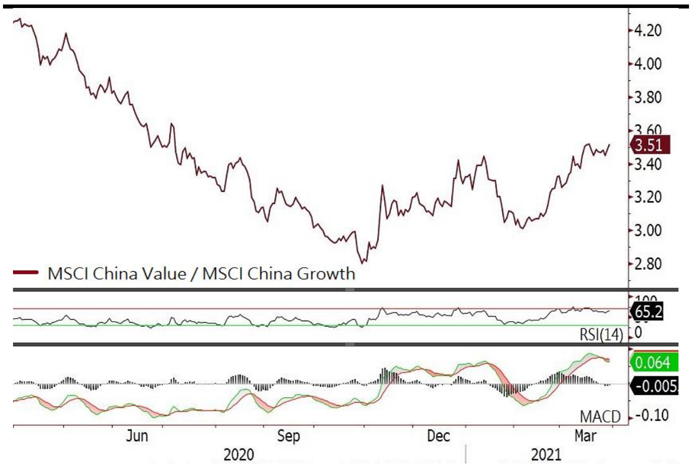
MSCI China Value overbought relative to MSCI China Growth

The momentum of value stocks relative to growth stocks have been remarkable since mid-Feb, but seem to start waning. Fig. 18 shows that MSCI China Value relative to Growth is close to overbought level (RSI nears 70), and MACD has just made a bearish crossover, suggesting this round of outperformance by value stocks may end soon.

NASDAQ uptrend intact

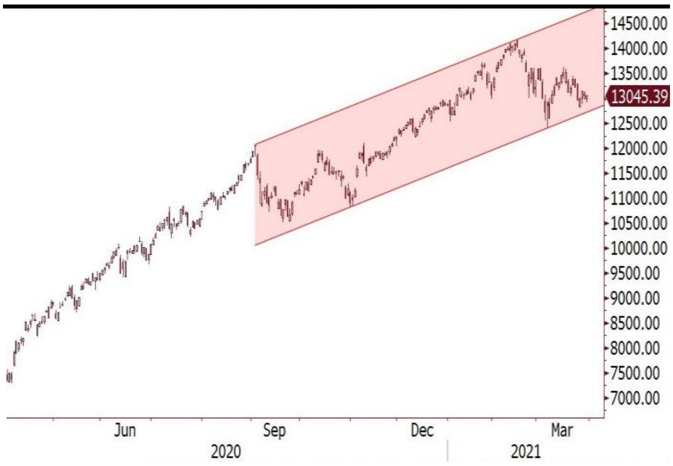
As the bellwether for tech / growth stocks, the NASDAQ Composite is still within a medium-term upward channel, suggesting the uptrend is intact, and could well find a support near the bottom of the channel (Fig. 19). NASDAQ remaining in uptrend should bode well for tech / growth stocks in China / HK too.

Figure 18: MSCI China Value / Growth



Source: Bloomberg, CMBIS

Figure 19: NASDAQ remains in upward channel

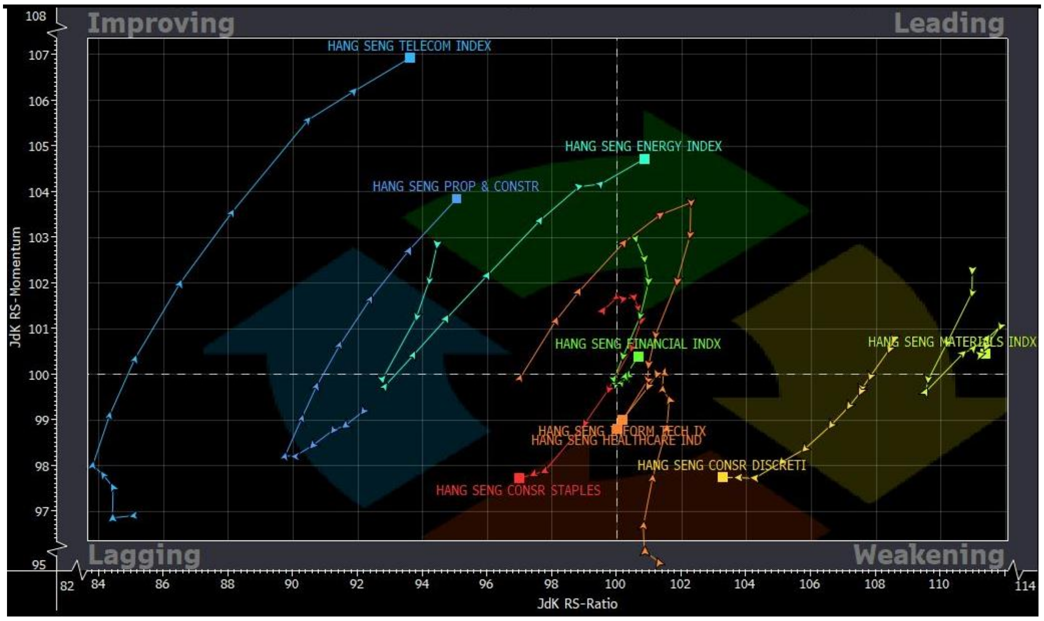


Source: Bloomberg, CMBIS

Rotation to value nearing an end?

For the past 6 weeks or so, **there was an obvious rotation from growth / new-economy sectors to value / old-economy stocks**. As illustrated in a weekly Relative Rotation Graph (RRG) of the Hang Seng Composite Index (Fig. 20), growth sectors such as IT and Consumer Staples sank from "Leading" to "Weakening" or "Lagging". On the contrary, value stocks such as Property and Energy advanced from "Lagging" to "Improving" or "Leading".

Figure 20: Weekly RRG of Hang Seng Composite Index on 31 Mar

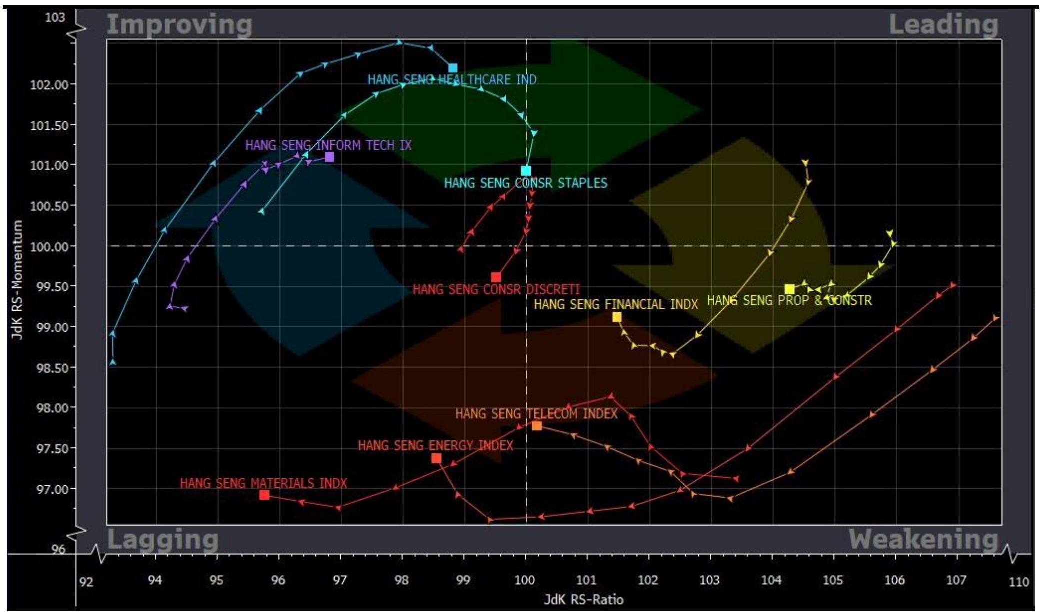


Source: Bloomberg, CMBIS

However, this round of sector rotation may be nearing an end. The daily RRG of the HSCI (Fig. 21) shows a somewhat opposite picture to the weekly RRG, i.e. value sectors are weakening while growth stocks are improving in momentum.

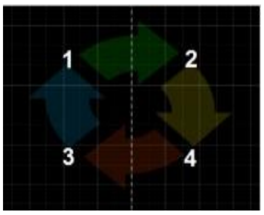
This is NOT to say we expect a rotation back to growth stocks any time soon. Sector rotation between growth and value does not always happen. It did happen several times over the past 12 months, triggered by COVID-19 and the subsequent recession and recovery. But as the economy gradually normalises, such rotation should occur less often, or at least less dramatically.

Figure 21: Daily RRG of Hang Seng Composite Index on 31 Mar



Source: Bloomberg, CMBIS

**Explanatory note:*



1: Underperforming benchmark but momentum is UP

2: Outperforming benchmark and momentum is UP

3: Underperforming benchmark and momentum is DOWN

4: Outperforming benchmark but momentum is DOWN

Sectors tend to rotate clockwise on the graph

Strategy: Stock picking is now the key

Unlike in last month's Strategy Report where we had a strong preference for cyclicals over growth stocks, **we are now relatively neutral on both cyclical and growth stocks**. While cyclicals should enjoy further re-rating as economic recovery continues over the medium term, their momentum is starting to weaken in the short term. On the other hand, growth stocks' value is starting to re-emerge after the recent correction. As such, we expect less contrasting performance in value and growth stocks in coming weeks.

Bottom-up stock picking, instead of top-down sector allocation, is now more important in generating alpha.

We favour industry leaders, because they are better positioned to emerge stronger and expand market share post-pandemic, and should be more defensive in case the stock market correction lasts for longer.

In particular, we like industry leaders with either:

1) A better-than-expected FY20 result
   i. **Sunny Optical (2382 HK)** – FY20 earnings beat consensus by 13%.
   ii. **Kuaishou (1024 HK)** – FY20 net loss better than consensus; expect strong momentum in user growth to continue.

2) A promising 1Q21E guidance
   i. **Zoomlion (1157 HK / 000157 CH)** – 1Q21E +114%-153% YoY according to profit alert.
   ii. **ZTE (763 HK)** – 1Q21E +130%-208%, or ~70% excluding one-off items, according to profit alert.

3) Upside in consensus earnings
   i. **BYD Electronics (285 HK)** – Our FY21E/22E EPS are 18%/13% above consensus.

4) Cheap valuation with turnaround story
   i. **WH Group (288 HK)** – FY20 earnings missed due to exceptional items, but we expect record high adj. net profit in FY21E. Share price is 35% below peak, and FY21E adj. P/E at only 8.4x vs historical average 11.0x.

Figure 22：Preferred industry leaders

Sector	Company	Ticker	Rating	Target Price	Latest Report
Internet	Kuaishou	1024 HK	BUY	HK$382	Link
Technology	Sunny Optical	2382 HK	BUY	HK$254.3	Link
	BYD Electronics	285 HK	BUY	HK$56.2	Link
	ZTE	763 HK	BUY	HK$28.1	Link
Capital goods	Zoomlion	1157 HK / 000157 CH	BUY	HK$16.0 / RMB17.8	Link
Consumer	WH Group	288 HK	BUY	HK$9.6	Link

Source: CMBIS

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