

China / HK Market Weekly

Short-term pullbacks amid COVID resurgence

Last week (4–8 Jul), US stocks rebounded as strong employment data eased recession fears, but China / HK stock declined mildly after outperforming DM in the previous weeks. Widening COVID outbreaks in China are causing some concerns. Looking ahead to this week, investors will focus on the COVID epidemic & Q2 GDP data of China, CPI data & Q2 earnings of the US. We expect the current resurgence in COVID cases in China to trigger short-term pullbacks, but we expect China / HK stocks to moderately outperform the US after this healthy correction. We suggest a buy-on-dips strategy on China growth stocks such as Internet, Healthcare & Consumer Discretionary which enjoy re-rating in the medium term due to economic recovery and easing regulatory concerns.

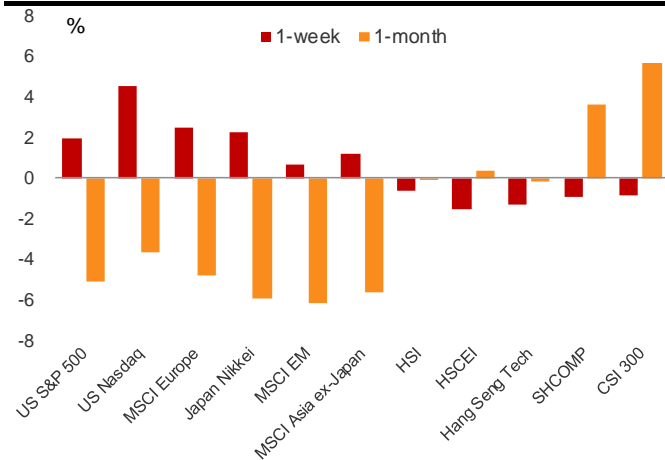
- **Market recap:** The HSI / CSI 300 declined by 0.6% / 0.9% last week, giving up some gains from the previous weeks (Fig. 1), as a climb in COVID cases in some provinces brought some risks to the economic recovery. Meanwhile, a slightly higher-than-expected CPI in China may limit the room for further monetary easing. By sector, value stocks led declines, while Healthcare was one of the few sectors which managed to rise (Fig. 3-4).
- **Interest rates:** Expectations of Fed rate hikes rebounded after the release of strong US nonfarm payrolls in Jun, but the implied Fed funds rate by the end of 2022 is still lower than three weeks ago (Fig. 10-11). Part of the US yield curve (10-year vs. 2-year) inverted again (the last time was in early-Apr), indicating recession risks.
- **Sentiment:** Risk indicators actually improved in HK stock market, despite some profit-taking, as "Fear Index" VHSI retreated to the lowest in three months, and short-sell ratio on HK mainboard dropped to below 16%, the lowest since Jan (Fig. 20 & 21). By sector, short-sell ratio decreased in IT, Financials & Property, and increased in Materials, Industrials & Consumer.
- **Valuation:** After a strong run in China / HK stocks over the past two months, valuations gaps between China / HK and other major markets have narrowed. HSI's forward P/E is approaching 10-yr mean, while that of the US has dropped to below 10-yr mean (Fig. 33).
- **Earnings:** After four months of earnings downgrades, FY22E EPS consensus of the HSI / HSTECH / CSI 300 were largely unchanged in the past three weeks (Fig. 37-39), and might remain relatively stable before the 2Q earning season kicks start in late-Jul.
- **Market outlook & sector views:** The latest resurgence in COVID cases in China is likely to trigger **short-term pullbacks in China / HK stocks** after strong outperformance since mid-May. However, barring the unlikely case of the epidemic getting out of control and a reimplement of strict lockdowns in tier-1 cities, we **expect China / HK stocks to moderately outperform the US after this healthy correction**, due to the difference in economic and monetary cycles in China and the US. We suggest a buy-on-dips strategy on **China growth stocks such as Internet, Healthcare & Consumer Discretionary** which, despite short-term volatilities, should enjoy re-rating in the medium term due to economic recovery and easing regulatory concerns.

Daniel So, CFA
 (852) 3900 0857
 danielso@cmbi.com.hk



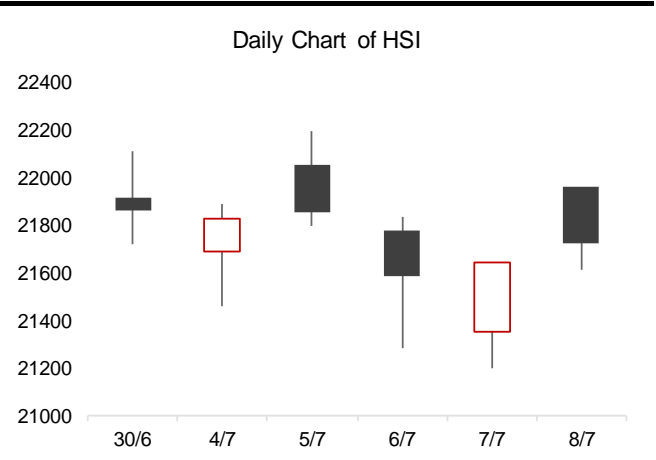
Market Recap

Figure 1: Weekly global markets returns: China/HK underperformed, partly due to profit-taking



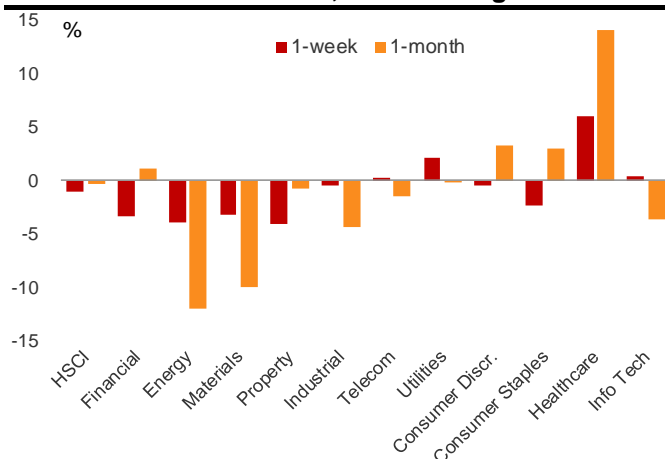
Source: Bloomberg, CMBIGM

Figure 2: HSI was range-bound between 21200-22200



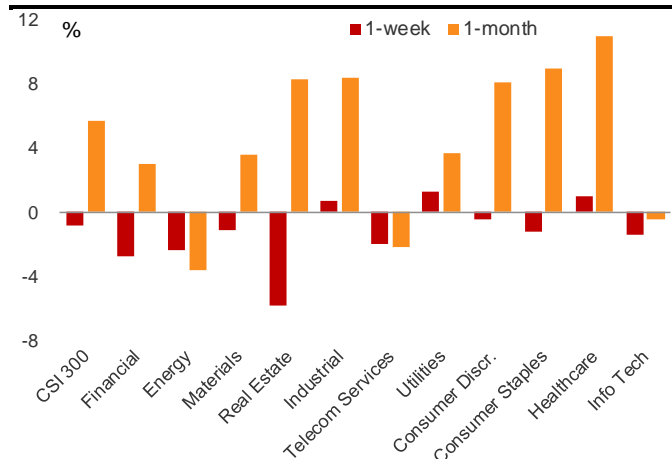
Source: Bloomberg, CMBIGM

Figure 3: Hang Seng Composite Index sectors: Value stocks led declines; Healthcare gained



Source: Bloomberg, CMBIGM

Figure 4: CSI 300 Index sectors: Value stocks led declines



Source: Bloomberg, CMBIGM

Figure 5: IT, Healthcare & Consumer Discretionary remained in "Improving" zone in weekly Relative Rotation Graph, indicating improved momentum



Source: Bloomberg, CMBIGM

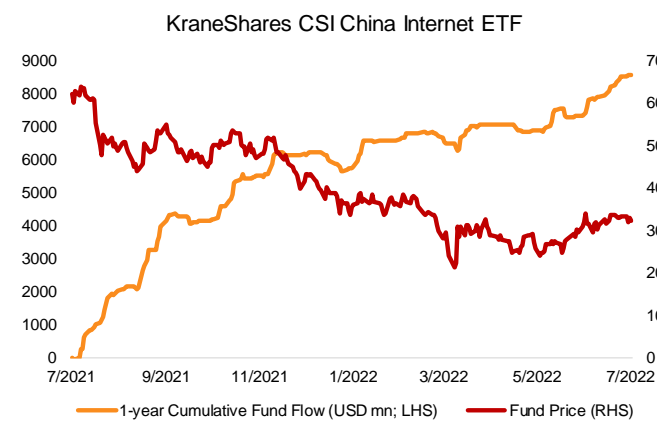
Figure 6: China Growth stocks outperformed Value in recent weeks, breaking a downtrend on the chart of relative performance



Source: Bloomberg, CMBIGM

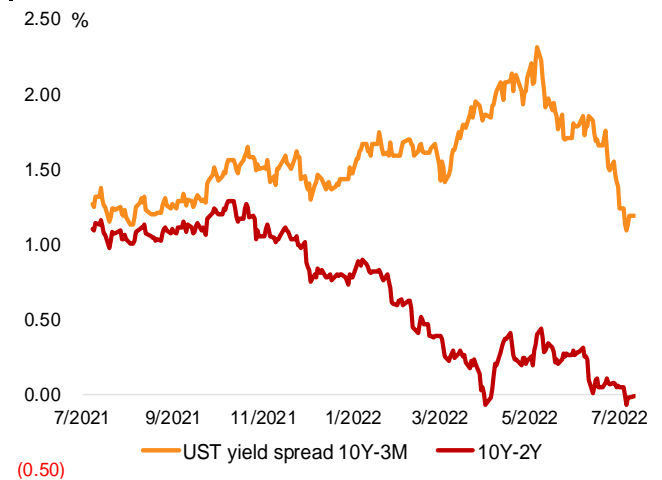
Fund Flows

Figure 7: KWEB, the largest China Internet ETF, recorded strong inflows in recent weeks



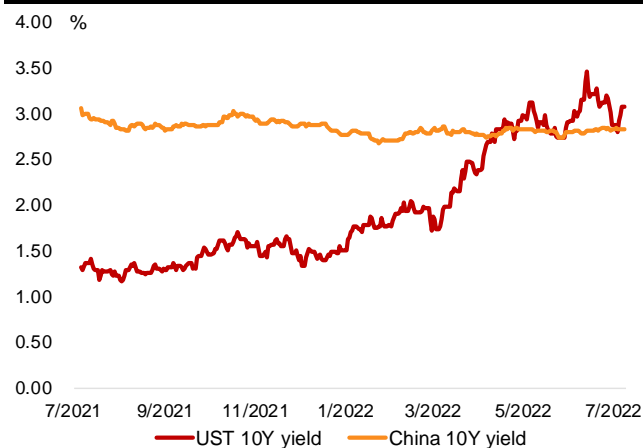
Source: Bloomberg, CMBIGM

Figure 8: UST 10-yr & 2-yr spread sank to negative



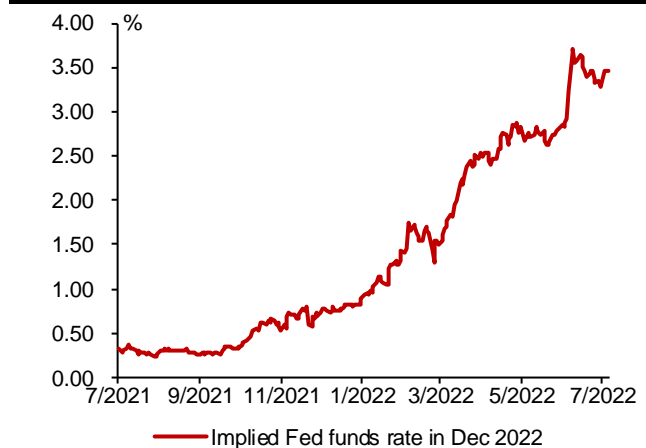
Source: Bloomberg, CMBIGM

Figure 9: US-China 10-year yield spread narrowed in recent weeks as US yield declined



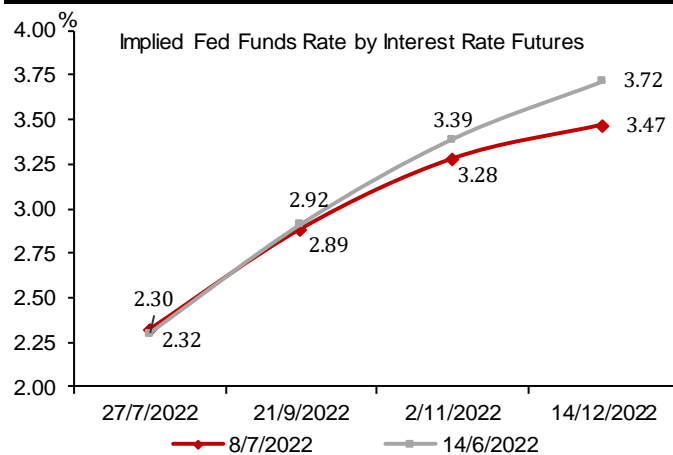
Source: Bloomberg, CMBIGM

Figure 10: Implied Fed funds rate in Dec 2022 rebounded by 16 bps last week to 3.47%



Source: Bloomberg, CMBIGM

Figure 11: Implied Fed funds rate rebounded last week, but still some way off the peak in mid-Jun



Source: Bloomberg, CMBIGM

SH/SZ-HK Stock Connect

Figure 12: Southbound inflows shrank last week

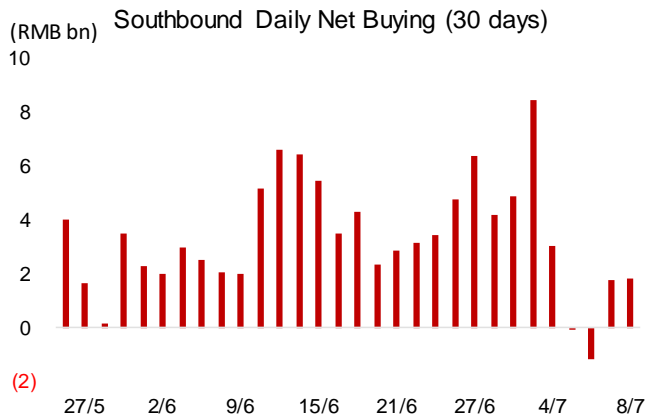


Figure 13: Northbound inflows shrank too

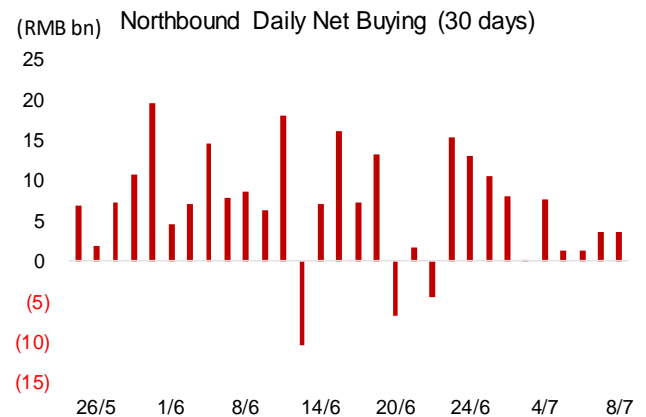


Figure 14: Southbound net buying improved in Jun

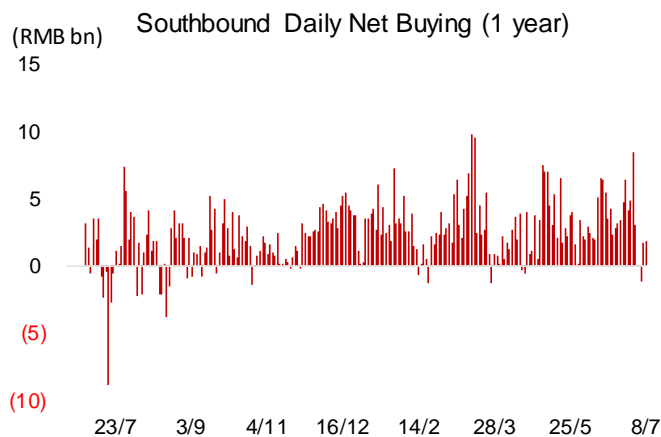


Figure 15: Northbound inflows moderating

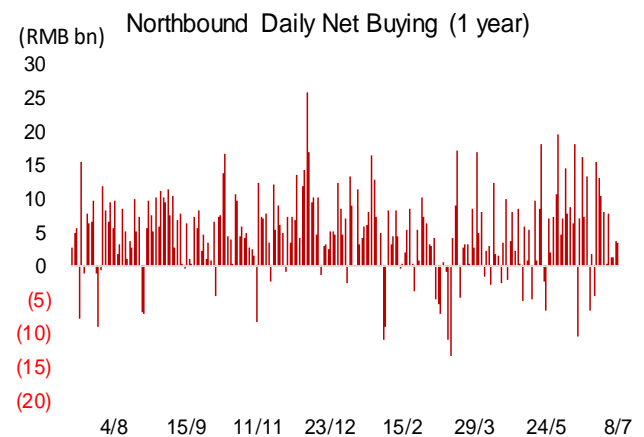


Figure 16: Northbound inflows improved since mid-May, while Southbound inflows remained steady

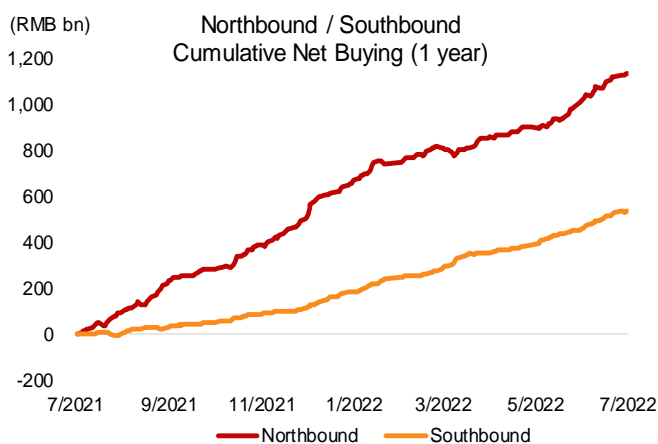


Figure 17: AH premium widened by 1.2 ppt last week as H-shares declined more than A-shares



Figure 18: Southbound weekly Top 10 active stocks

(HKD mn, cumulative)		Turnover	Net Buying
Tencent	700 HK	13,787	1,283
Geely Automobile	175 HK	3,678	-710
Meituan	3690 HK	7,223	-3,187
GCL Technology	3800 HK	1,791	579
CMOC Group	3993 HK	280	48
Wuxi Biologics	2269 HK	6,165	-245
Brii Biosciences	2137 HK	253	41
China Mobile	941 HK	244	-191
Xiaomi	1810 HK	1,531	355
Great Wall Motor	2333 HK	1,601	-825

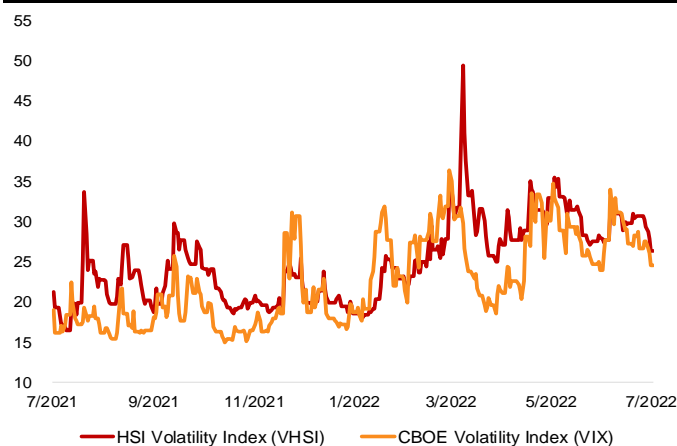
Source: Wind, CMBIGM

Figure 19: Northbound (SH) Top 10 active stocks

(RMB mn, cumulative)		Turnover	Net Buying
LONGi Green Energy	601012 CH	7,055	91
Ming Yang Smart Energy	601615 CH	2,291	-1,077
Kweichow Moutai	600519 CH	7,856	1,443
Tongwei	600438 CH	5,851	79
Inner Mongolia Yili	600887 CH	4,628	-289
CTG Duty Free	601888 CH	5,951	1,358
Ping An Insurance	601318 CH	762	247
China Merchants Bank	600036 CH	2,844	143
WuXi AppTec	603259 CH	5,492	-868
Will Semiconductor	603501 CH	3,412	-800

Source: Wind, CMBIGM

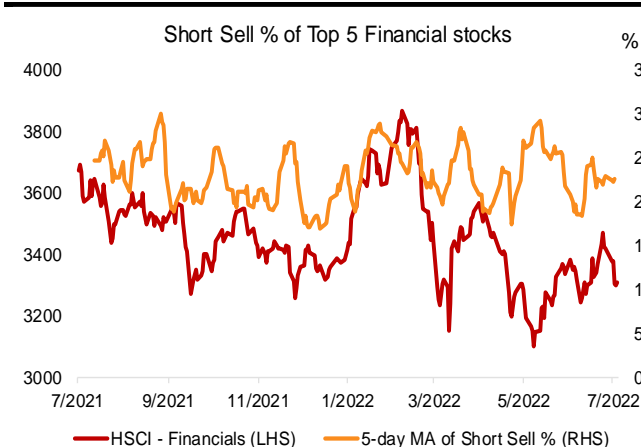
Sentiments

Figure 20: "Fear Index" VHSI retreated to 26.3, a three-month low

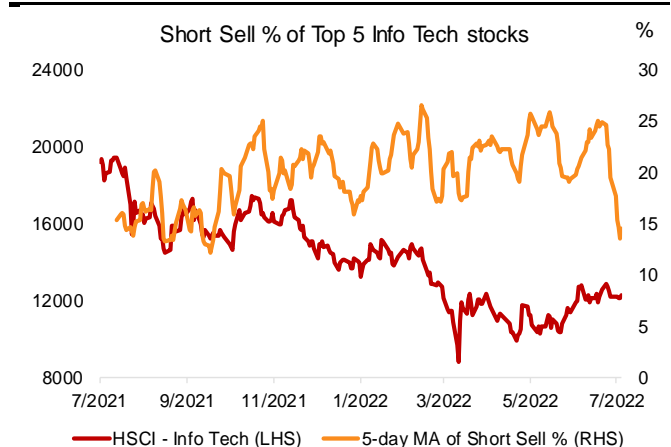
Source: Bloomberg, CMBIGM

Figure 21: Short sell % on HK mainboard dropped to below 16%

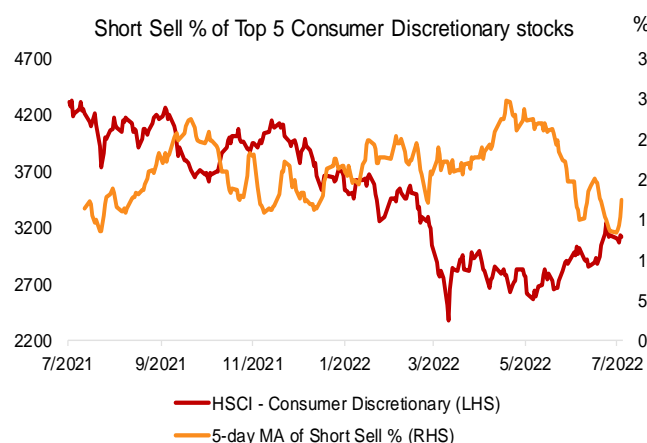
Source: Bloomberg, CMBIGM

Figure 22: Short sell % in HK - Financials

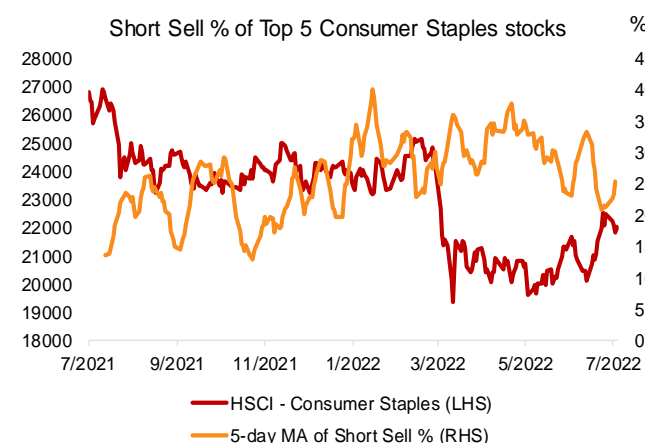
Source: Bloomberg, CMBIGM

Figure 23: Short sell % in HK - Info Tech

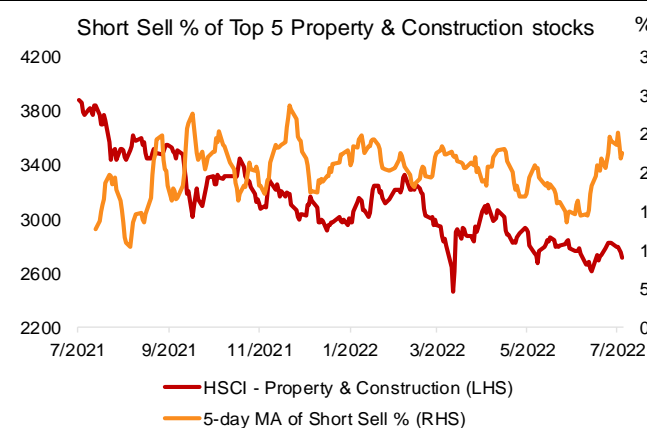
Source: Bloomberg, CMBIGM

Figure 24: Short sell % in HK – Consumer Discretionary.

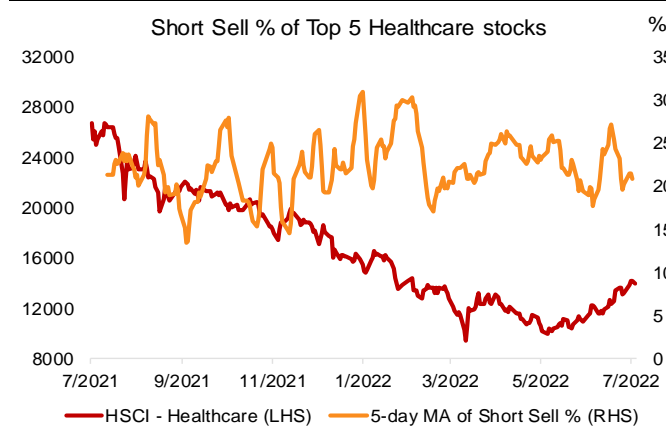
Source: Bloomberg, CMBIGM

Figure 25: Short sell % in HK – Consumer Staples

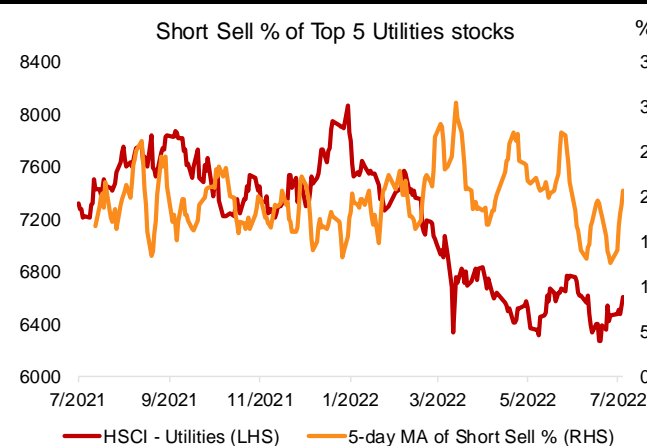
Source: Bloomberg, CMBIGM

Figure 26: Short sell % in HK - Property

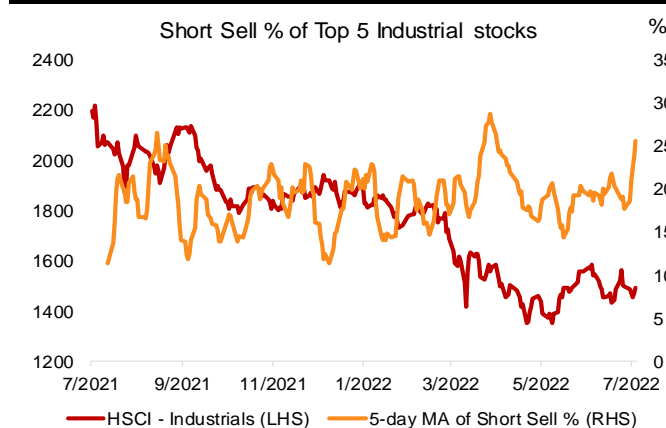
Source: Bloomberg, CMBIGM

Figure 27: Short sell % in HK – Healthcare

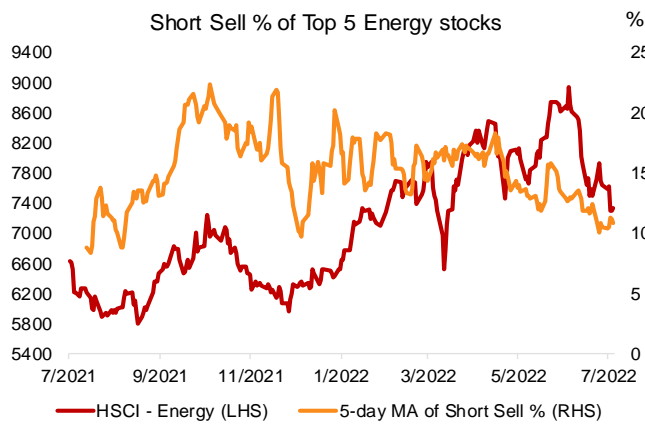
Source: Bloomberg, CMBIGM

Figure 28: Short sell % in HK – Utilities

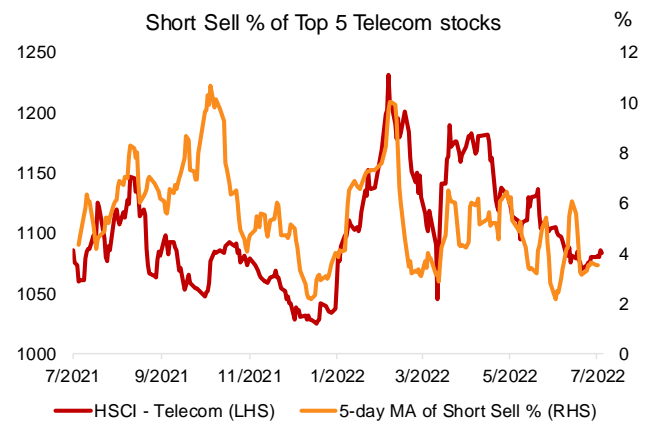
Source: Bloomberg, CMBIGM

Figure 29: Short sell % in HK – Industrials

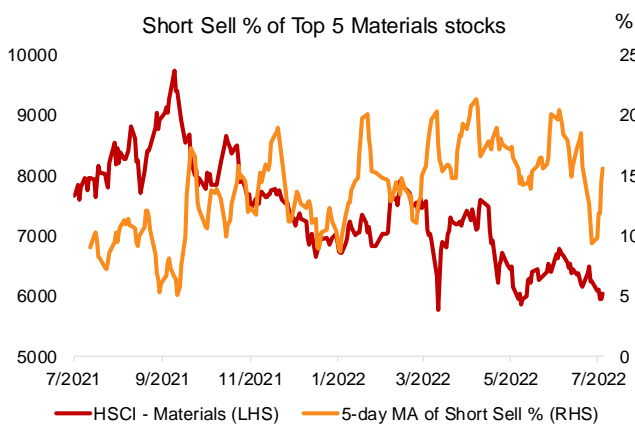
Source: Bloomberg, CMBIGM

Figure 30: Short sell % in HK – Energy

Source: Bloomberg, CMBIGM

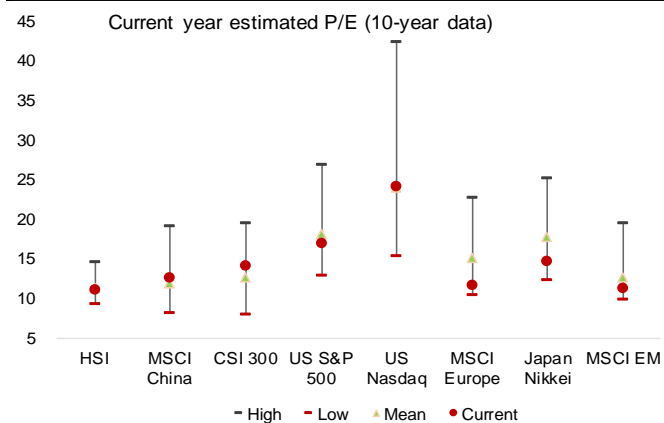
Figure 31: Short sell % in HK – Telecom

Source: Bloomberg, CMBIGM

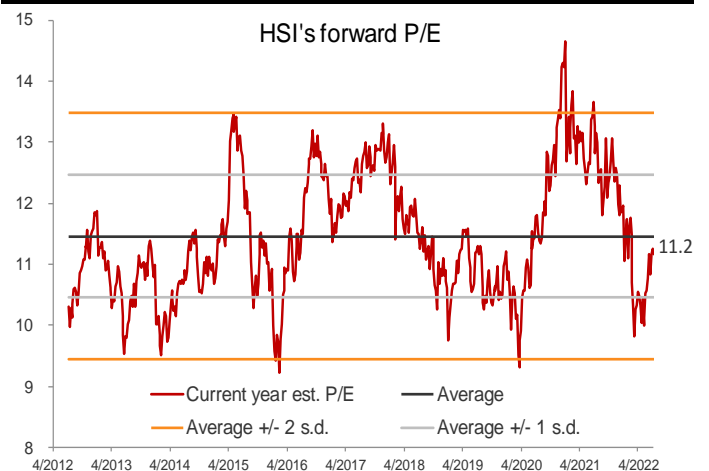
Figure 32: Short sell % in HK – Materials

Source: Bloomberg, CMBIGM

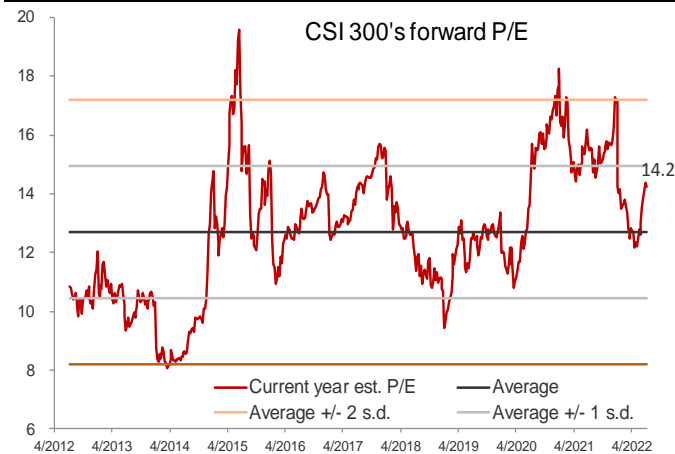
Earnings & Valuations

Figure 33: HK & US stocks' P/E moved closer to 10-yr mean after divergent performance in recent weeks

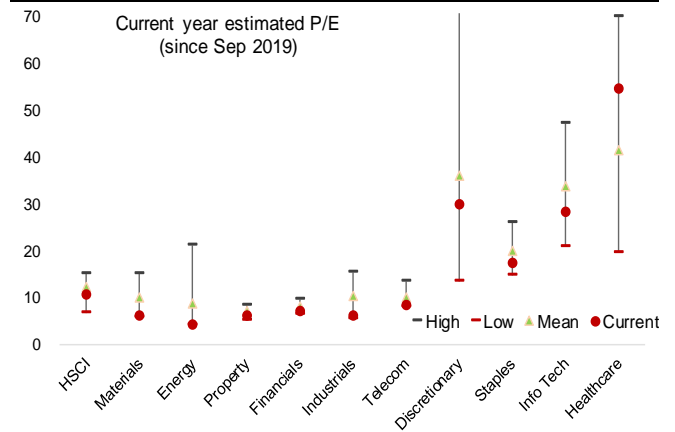
Source: Bloomberg, CMBIGM

Figure 34: HSI's forward P/E approaching 10-yr mean

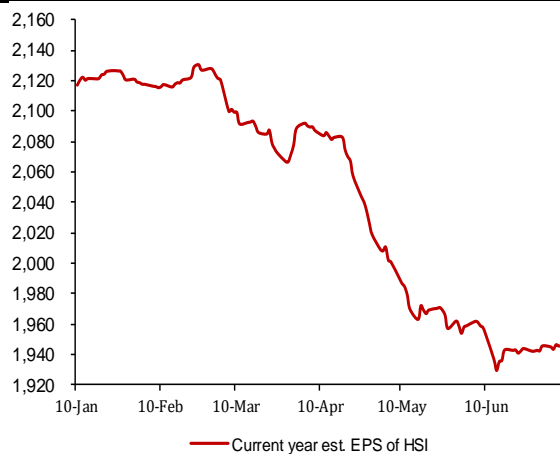
Source: Bloomberg, CMBIGM

Figure 35: CSI 300's forward P/E above 10-yr mean

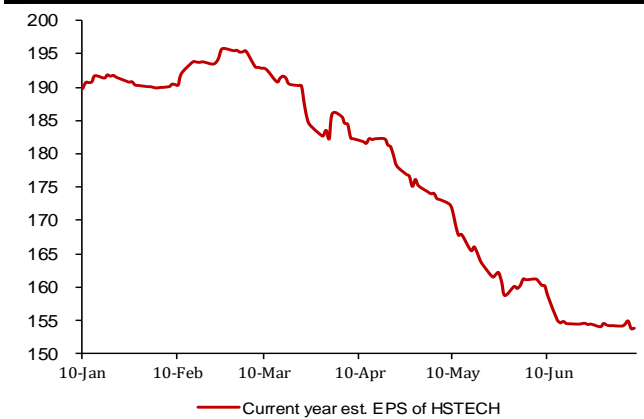
Source: Bloomberg, CMBIGM

Figure 36: Most HSCI sectors' P/E are near troughs

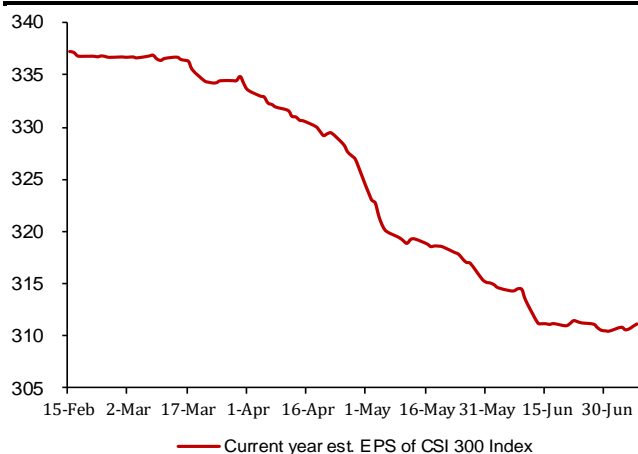
Source: Bloomberg, CMBIGM

Figure 37: EPS estimates of HSI were flat last week

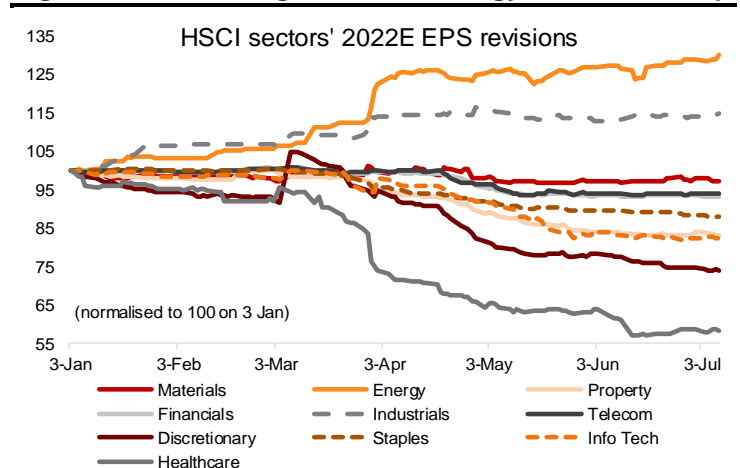
Source: Bloomberg, CMBIGM

Figure 38: EPS estimates of HSTECH Index were revised down by 0.2% last week

Source: Bloomberg, CMBIGM

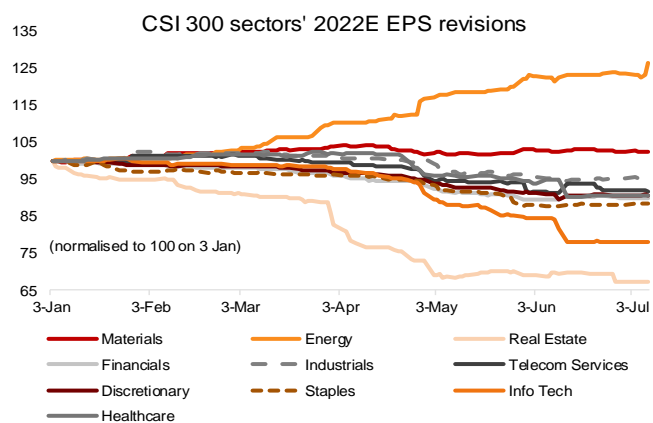
Figure 39: EPS estimates of A-shares were revised up by 0.2% last week

Source: Bloomberg, CMBIGM

Figure 40: HK earnings revision: Energy & Industrials up

Source: Bloomberg, CMBIGM

Figure 41: A-shares earnings revision: Energy & Industrials up



Source: Bloomberg, CMBIGM

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Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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