招銀国际 CMB INTERNATIONAL
招商银行全资附属机构 A Wholly Owned Subsidiary Of China Merchants Bank

Strategy Report

Gauging a bottom of the HSI

The HSI slumped to a YTD low 24,582 on 20 Aug, retreating by 20%+ from its peak 31,183 in Feb, due to ongoing policy risks in China and to a lesser extent a more hawkish Fed. Based on valuation, charts and sentiment, we think 24,000 could be a short-term bottom, but major catalysts would be needed to stage a strong rebound. Reiterate our preference for sectors supported by policy.

- **Valuation: adjusted HSI's forward P/E near trough.** At face value, the HSI's 2021E P/E is higher than 10-year average, but valuation has been lifted by having added ~20 ppts of growth stocks since 1H 2020. If we exclude the 12 stocks that only recently became blue chips, this adjusted HSI is trading at only 9.4x/8.7x 2021E/2022E P/E, 2 s.d. below 10-year average, and similar to the several troughs in the last decade.
- **Technical analysis: support at 24,000.** The HSI's long-term uptrend since 2008 is now around 24,000, which should offer some support. In the shorter term, while its RSI has again fallen into oversold territory, we may wait for a "triple divergence" between the HSI and its RSI to call a bottom.
- **Sentiment: VHSI hitting panic zone.** The HSI Volatility Index (VHSI), equivalent to the "fear index" VIX, surged to over 28 on 20 Aug, which is around the numerous peaks over the past 12 months. We think it implies investors are showing panic, which has often been a contrarian signal.
- **Major catalysts are needed.** Expect the market to be policy news-driven in the short term. Even if the HSI reaches a short-term bottom, some major catalysts would be needed to drive a meaningful rebound. Taking the bear market in 2015 as a reference, we believe such catalysts include policy support, rebound in China's PMI, extra liquidity, weak USD and cheap valuation. But now we only have cheap valuation. Without enough catalysts, the HSI will probably trade in a relatively low range (24,000 – 26,000) in upcoming weeks.
- **Strategy: Avoiding policy risks is still the key.** Investor confidence clearly got hurt by stringent policies, and will need more time and positive catalysts to recover. We reiterate our view of "staying on the side line to wait for more clarity on China's regulatory policies", and identify NEV, New Energy, Machinery, Hardware to be the sectors to bottom fish first.

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

Market Data

Hang Seng Index	24,850
52-week High / Low	31,183/23,124
3-month avg. daily t/o	HK$163.6bn

Source: Bloomberg

Indices Performance

	HSI	HSCEI	HSTECH
1-month	-8.8%	-11.4%	-18.9%
3-month	-12.7%	-17.9%	-27.8%
6-month	-18.9%	-25.5%	-44.2%

Source: Bloomberg

12-month HSI Performance

Source: Bloomberg

Related Reports

1. Strategy Report – HSI constituent candidates in half-yearly review – 17 Aug 2021
2. Strategy Report – Buy growth stocks with little policy risk – 3 Aug 2021
3. Strategy Report – 2H Outlook: Growth stocks to regain momentum – 5 Jul 2021
4. Strategy Report – Short-term Value; Medium-term Growth – 1 Jun 2021
5. Strategy Report – Buy in May; HSI target raised – 3 May 2021
6. Strategy Report – Style shift to take a break – 1 Apr 2021
7. Strategy Report – Don't panic over rising bond yield – 3 Mar 2021
8. Strategy Report – HSI enhancement preview – 24 Feb 2021
9. Strategy Report – Follow the tide – 3 Feb 2021

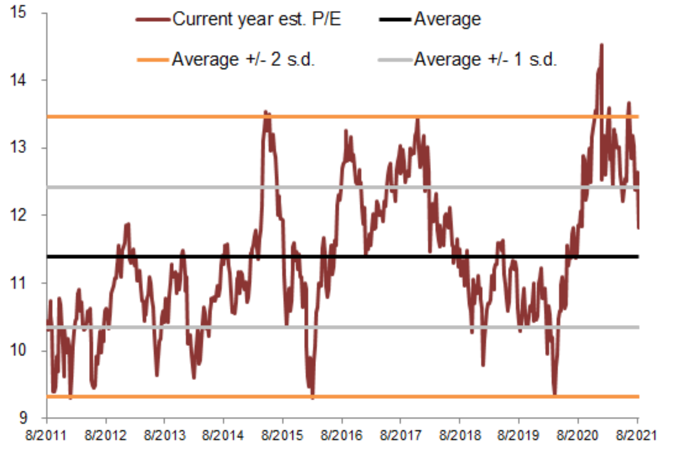
Valuation: adjusted HSI's forward P/E near trough

■ **2021E P/E only 9.4x excluding new blue chips**

At face value, the HSI's 2021E P/E is 11.9x, and does not look cheap if compared with 10-year average 11.4x. But as we pointed out in our August Strategy Report, HSI's valuation has been lifted by having added ~20 ppts of growth stocks since 1H 2020.

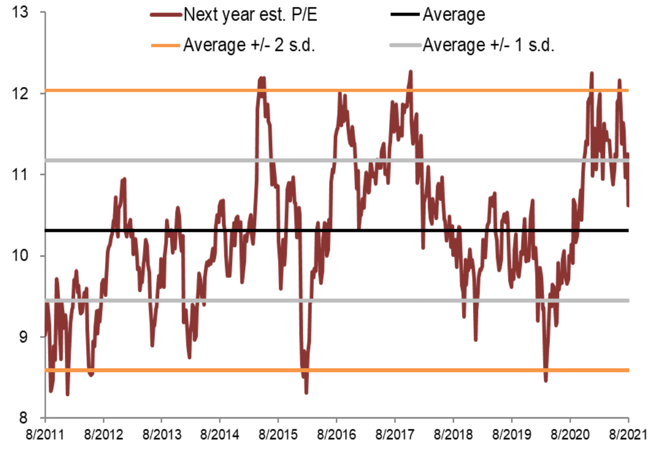
To make an apple-to-apple comparison, we removed the 12 stocks (of which 11 are growth stocks such as Alibaba, Meituan, Xiaomi) that have only recently become blue chips, and found that this **adjusted "old HSI" is trading at only 9.4x/8.7x 2021E/2022E P/E, 2 s.d. below 10-year average, and similar to the several troughs** as shown in Fig. 1 & Fig. 2.

Figure 1: HSI's current year estimated P/E



Source: Bloomberg, CMBIS

Figure 2: HSI's next year estimated P/E



Source: Bloomberg, CMBIS

Technical analysis: Long-term uptrend support at 24,000

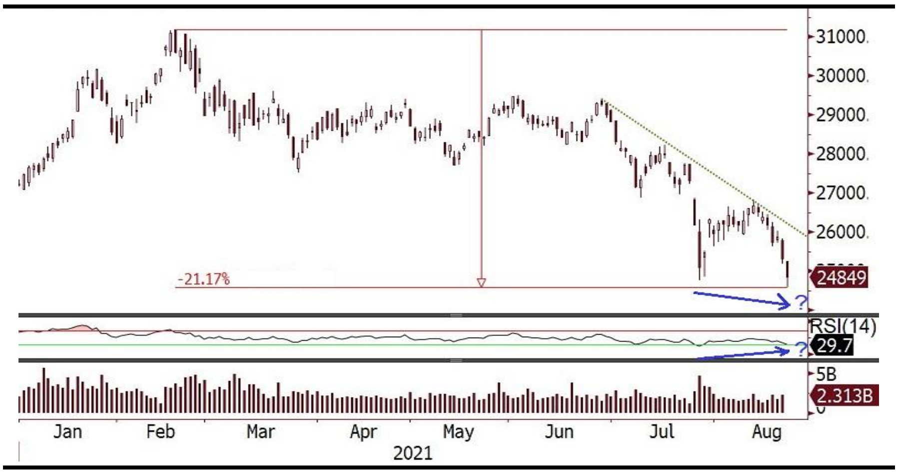
The HSI's long-term uptrend since 2008 (around 24,000 now) should offer some support.

Figure 3: HSI monthly chart since 2008

Source: Bloomberg, CMBIS

In the shorter term, should any technical rebound occur, there is a strong resistance at a downtrend (green line in Fig. 4). While RSI has again fallen into oversold territory, **we may wait for a "triple divergence" between the HSI and its RSI to call a bottom**.

Figure 4: HSI daily chart YTD

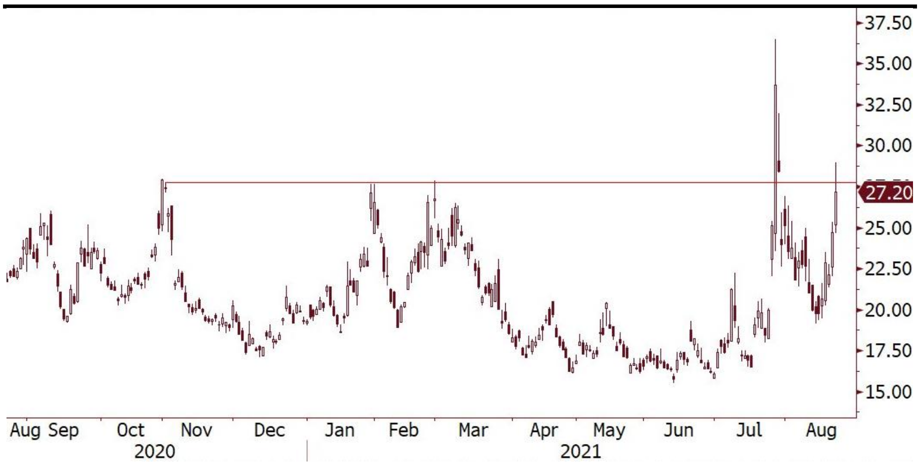


Source: Bloomberg, CMBIS

Sentiment: VHSI hitting panic zone

The HSI Volatility Index (VHSI), equivalent to the "fear index" VIX, surged to over 28 on 20 Aug, which is around the numerous peaks over the past 12 months. Admittedly it is hard to say the VHSI has reached an absolute peak or not, after all it did shoot up to 36 in Jul. Nonetheless, we think it implies **investors are showing panic, which has often been a contrarian signal**.

Figure 5: VHSI daily chart (1-year)



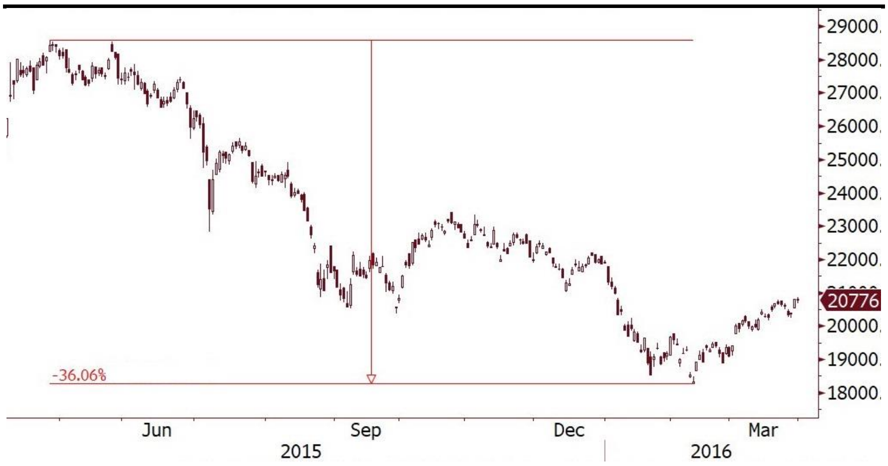
Source: Bloomberg, CMBIS

Potential positive catalysts?

Since the market turmoil over the past few weeks has been triggered by regulatory risks, we expect the market to be news-driven in the short term. As such, even if the HSI reaches a short-term bottom (~24,000 based on our analysis above), some major catalysts would be needed to drive a meaningful rebound.

We take the bear market in 2015 as a reference. The HSI slumped by 36% from the peak in Apr 2015 before bottoming out in Feb 2016.

Figure 6：HSI daily chart in 2015-2016



Source: Bloomberg, CMBIS

We believe the catalysts behind the rebound since Feb 2016 included:

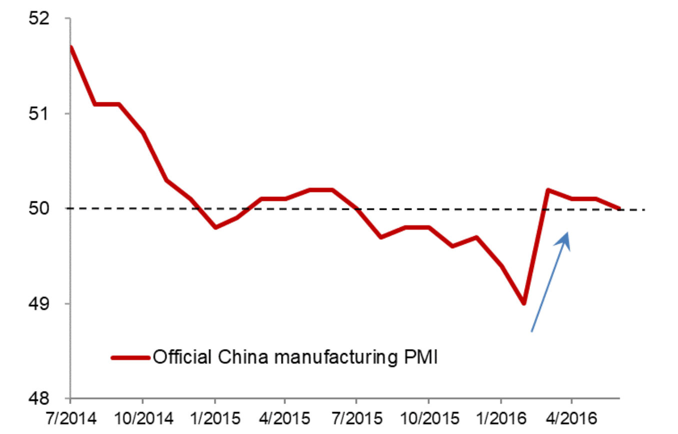
1. **Policy support from Beijing**, especially on fiscal front. Premier Li Keqiang began to sound more supportive on fiscal stimuli in Feb 2016.
2. **Cheap valuation**: HSI's estimated P/E was below 10x (Fig. 1 & 2).
3. **China's PMI started rebounding** in Mar 2016 (Fig. 7).
4. **Extra liquidity into A-shares** were expected: speculation that A-shares would be added to MSCI EM Index, and China's pension fund might enter the market.
5. **USD weakened** since Feb 2016 (Fig. 9).

This time around, how many of these boxes are ticked?

1. **Policy support? No.** It is clearly a major risk in the form of stringent regulations. Monetary and fiscal policies are becoming more supportive (e.g. RRR cut in Jul 2021 and Beijing vowed to speed up infrastructure projects), but more supports are probably needed.
2. **Cheap valuation? Yes.** HSI's adjusted est. P/E is below 10x, as explained above.
3. **China PMI rebounding? No.** Has been trending down for three months (Fig. 8).
4. **Extra liquidity? No**. On the contrary, foreign investors are generally selling, with "short China" becoming a common trade or even crowded trade.
5. **USD weakened? No.** On the contrary, it is making an upward breakout on "double bottoms" and "cup-and-handle" (Fig. 10), supported by the Fed turning slightly more hawkish towards tapering plan.

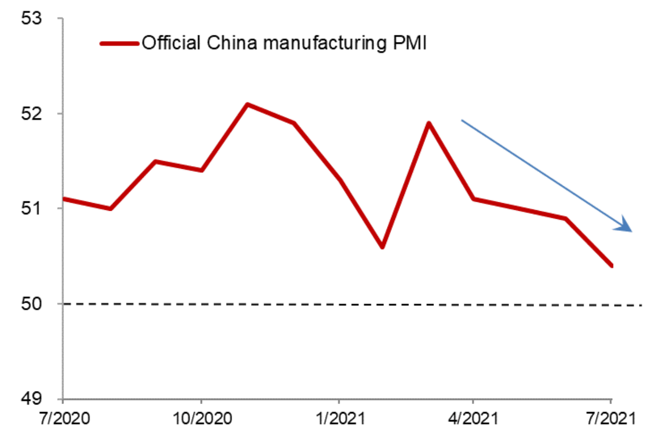
In short, there are not enough catalysts to drive HK stock market back to a bull run any time soon. The HSI will probably trade in a relatively low range (24,000 – 26,000) in upcoming weeks.

Figure 7: China's manufacturing PMI (2015-2016)



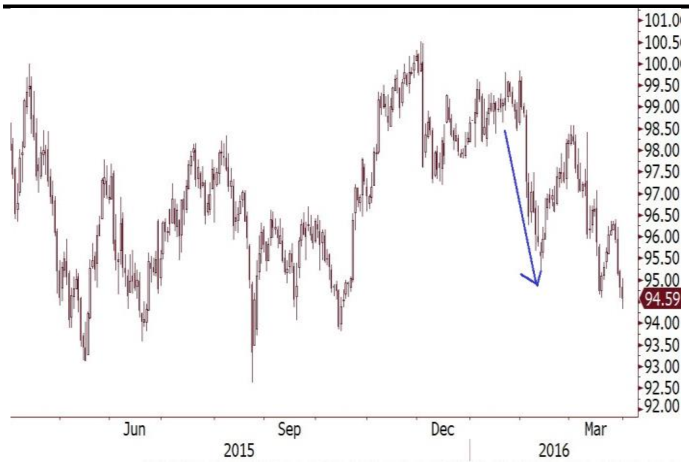
Source: Bloomberg, CMBIS

Figure 8: China's manufacturing PMI (2020-2021)



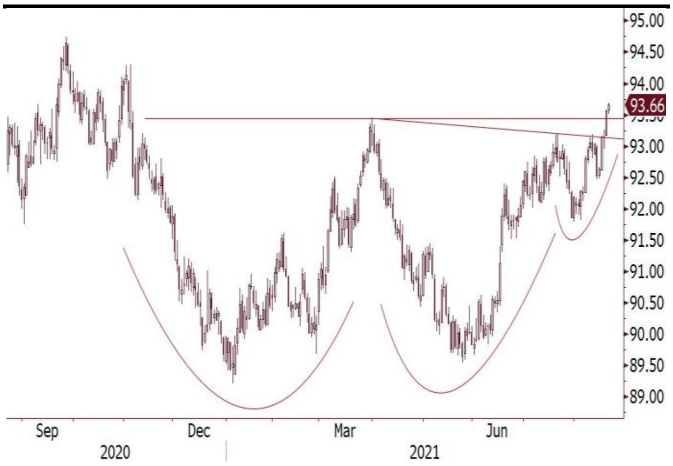
Source: Bloomberg, CMBIS

Figure 9: USD Index (2015-2016)



Source: Bloomberg, CMBIS

Figure 10: USD Index (2020-2021)



Source: Bloomberg, CMBIS

Strategy: Avoiding policy risks is still the name of the game

The bottom line is, investor confidence clearly got hurt by stringent policies, and will need more time and positive catalysts to recover.

In our August Strategy Report, we suggested "staying on the side line to wait for more clarity on China's regulatory policies", and we reiterate this view. We identify **NEV, New Energy, Machinery, Hardware to be the sectors to bottom fish first**.

Some of the names are **BYD (1211 HK), Suntien Green Energy (956 HK)**, **Tian Lun Gas (1600 HK)**, **BYDE (285 HK)** and **Xiaomi (1810 HK).**

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIS Ratings

BUY	: Stock with potential return of over 15% over next 12 months
HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
NOT RATED	: Stock is not rated by CMBIS
OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM	: Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Securities Limited

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

CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I)falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time)("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.,) of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

For recipients of this document in the United States

CMBIS is not a registered broker-dealer in the United States. As a result, CMBIS is not subject to US rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any US recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a US-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.