January Monthly Strategy

Keep faith in value stocks

Going into 2021, the pandemic is still taking centre stage. With vaccines being distributed at record pace, investor confidence in global economic recovery should be on the rise. Value stocks have been playing catch-up over the past two months, and we believe they will outperform again in Jan. We also prefer selective sectors that would benefit from China's policies.

- **China market sentiment remain bullish on policy support.** China's economic recovery began earlier than the West and has better visibility. Relatively more attention will be on policies in Q1. The "Two sessions" in which GDP growth target will be announced will be closely watched, and 2021 is the first year of the 14th Five-Year Plan. As such, we believe sectors which benefit more from the ongoing economic recovery or supportive policies would fare better in Q1.
- **Weak USD lifts stocks.** The USD has been on a downtrend in the past nine months, dragged by aggressive easing and twin deficits. A weak USD is naturally lending support to the CNY strength, which in turn bodes well for HK stock market's earnings and valuations.
- **Sector rotation from growth to value may go on,** because 1) vaccination strengthens the case for global recovery; 2) valuation gap between value & growth stocks is still way larger than pre-pandemic peaks; 3) low-base effect for value stocks' earning in Q1; 4) Chinese internet giants are facing anti-monopoly policy risks.
- **Technical Analysis:** HSI shows some bullish signals, breaking downtrends and MACD signalling "buy". RRG shows cyclicals may maintain lead over growth stocks. U.S. stocks, on the contrary, seem poised for a correction, as there is a divergence in Dow Jones Industrial and Transportation.
- **Strategy: Buy Value & Policy stocks.** Expect cyclical stocks to continue to play catch-up in Jan, as they are more sensitive to the reopening of economy and have a stronger earnings recovery. Growth stocks are expected to underperform in coming weeks. Wait for a better entry point into internet stocks.

Preferred sectors and stocks

Sector	Company
Consumer	Moutai (600519 CH), JS Global (1691 HK), Yum China (9987 HK), Pou Sheng (3813 HK)
Clean energy	China Gas (384 HK), Tian Lun Gas (1600 HK)
Capital goods	Zoomlion (1157 HK)
Education	Hope Edu (1765 HK)
Financials	China Life (2628 HK), CITIC Sec (6030 HK)

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Market Data

Hang Seng Index	27,473
52-week High / Low	29,175/21,139
3-month avg. daily t/o	HK$141.3bn

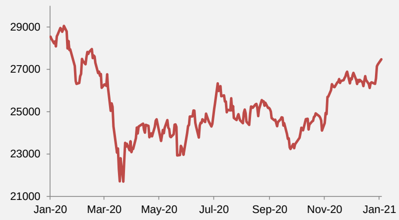
Source: Bloomberg

Indices Performance

	HSI	HSCEI
1-month	3.4%	0.6%
3-month	17.1%	14.1%
6-month	12.5%	9.9%

Source: Bloomberg

12-month HSI Performance



Source: Bloomberg

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COVID-19 new variant vs. vaccines

New virus strain more transmissible, but vaccines should work

The COVID-19 pandemic has dominated global markets in 2020. Coming into 2021, it would remain the dominating factor at least in the early months.

Recent news flows are mixed. On the negative side, the outbreak in some major countries, particularly the U.K., has been worsening, with a new and "more transmissible" coronavirus strain first identified in the U.K. In the U.S., at least three states, namely California, Florida and Colorado, have identified cases of that new virus strain. The U.K. announced a new national lockdown in England on 4 Jan. Fortunately, **there is no evidence to suggest that the new virus strain is more deadly, and early indications are that vaccines should be effective against it**.

Vaccines made available at record pace

On the positive side, some countries have approved COVID-19 vaccines and started mass vaccination. According to Bloomberg, so far more than 12.3 million doses of vaccines have been administered in 30 countries (Fig. 1), and 8.25 billion doses have already been ordered. That does not mean the entire population on earth would be covered, because most vaccines need two doses, many developing countries may not get enough supplies, and ultra-cold storage requirements make some vaccines difficult to deliver to distant regions.

Nevertheless, investor sentiment should be boosted by the fact **that vaccines have been successfully developed in less than a year and are being made available to the public at a record pace, thereby strengthening the case for a global economic recovery**.

There are, of course, uncertainties about vaccination. Will enough people be willing to get jab to achieve mass immunity? Will the vaccines turn out to be as effective as prior tests suggested? Will new variants of virus become resistant to existing vaccines? Will social and business activities return to normal after mass vaccination? We may find out the answers in the medium term. For now, until some bad news emerges, we believe investors are more likely to react positively.

Figure 1: No. of vaccine administered and secured in major economies

Country/Region	No. of doses administered	No. of people covered by vaccine deals	As % of population
Global Total	***12,368,187***	*N.A.*	*N.A.*
China	4,500,000	220,000,000*	16%*
U.S.	4,328,705	555,000,000	169%
U.K.	947,206	196,844,000	295%
Russia	800,000	80,000,000	55%
Germany	238,809	152,468,000	184%
Canada	114,766	113,879,000	304%
Italy	84,730	110,755,000	184%
France	516	118,943,000	184%
Japan	N.A.	151,317,000	120%
Australia	N.A.	58,678,000	230%
Hong Kong	N.A.	7,500,000	100%

Source: Bloomberg, CMBIS, updated on 4 Jan at 09:04 HKT
*Would cover 77% of China's population if include 1.4 bn doses of annual domestic production capacity

China market sentiment remain bullish on policy support

Focus on policies in Q1

In China, as COVID-19 has been under control much earlier than in the U.S. and Europe, its economic recovery began earlier and has better visibility. While vaccination will be one of the market focuses in Q1, relatively more attention will be on policies.

The “Two sessions” in March in which GDP growth target will be announced will be closely watched, and 2021 is the first year of the 14th Five-Year Plan. As such, **we believe sectors which benefit more from the ongoing economic recovery or supportive policies would fare better in Q1.**

The Central Economic Work Conference held in Dec 2020 outlined eight key tasks for 2021. Among the key tasks, strengthening strategic sci-tech competitiveness, improving supply chains toward an independent and controllable position, strengthening anti-monopoly efforts, and committing to peak-carbon and carbon neutrality are newly added.

Much emphasis has been placed on boosting domestic demand, highlighting the need for effective institutional arrangements in guiding consumption, savings and investment, more steps to create jobs, refining social protection system, improving income allocation structure and expanding middle-income groups.

Overall speaking, **long-term beneficiaries from these policies may include high-tech industrials, consumption, education, healthcare, new infrastructure, modern logistics, agriculture, new energy and environmental protection**.

Weak USD lifts stocks

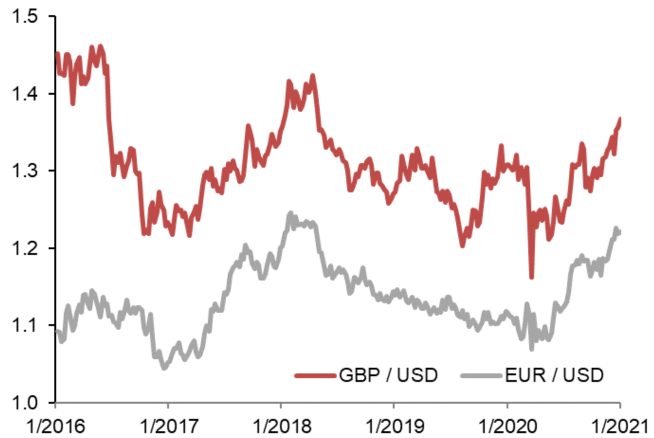
USD dragged into downward spiral by twin deficits

The USD has been on a downtrend in the past nine months, due to rising risk appetite, aggressive easing by the Fed (zero interest rate, unlimited QE, targeting average inflation, pledging zero rate for several years), and widening U.S. fiscal and trade deficits.

Figure 2: USD close to 3-year low

Source: Bloomberg, CMBIS

Figure 3: GBP & EUR rebounding since Mar 2020



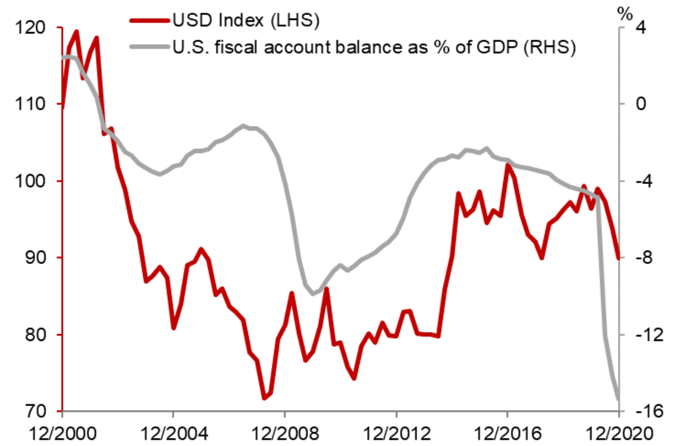
Source: Bloomberg, CMBIS

The U.S. Congressional Budget Office (CBO) projects a federal budget deficit equivalent to 16% of GDP in 2020, the largest since 1945. The deficit in 2021 is projected to be 8.6% of GDP, still at exceptionally high level, as between 1946-2019 the deficit ratio has been larger than that only twice. **Large fiscal deficits have a high correlation with weak USD** (Fig. 4).

The U.S. current account deficit widened to 3.4% of GDP in Q3 2020, the highest since 2008. Similarly, **large current account deficits have a high correlation with weak USD** (Fig. 5).

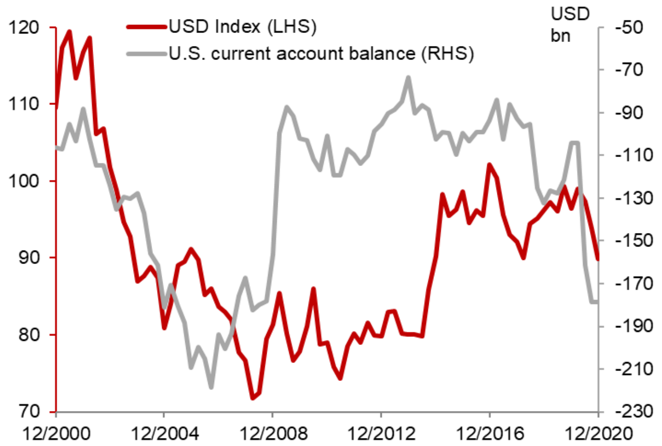
In contrast, the European Union runs a huge current account surplus, largely thanks to Germany. Moreover, the U.K. and EU have just reached a last-minute deal to avoid no-deal Brexit, exerting further downward pressure on the USD.

Figure 4: USD and U.S. fiscal deficits



Source: Bloomberg, CMBIS

Figure 5: USD and U.S. current account deficits

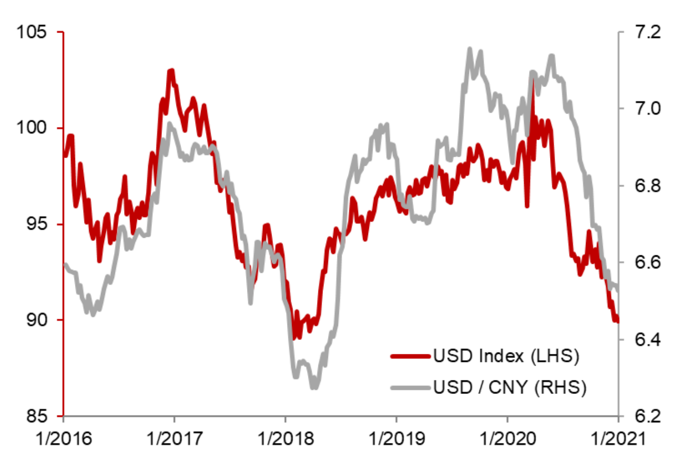


Source: Bloomberg, CMBIS

Weak USD ⇒ Strong CNY ⇒ Higher HSI valuation

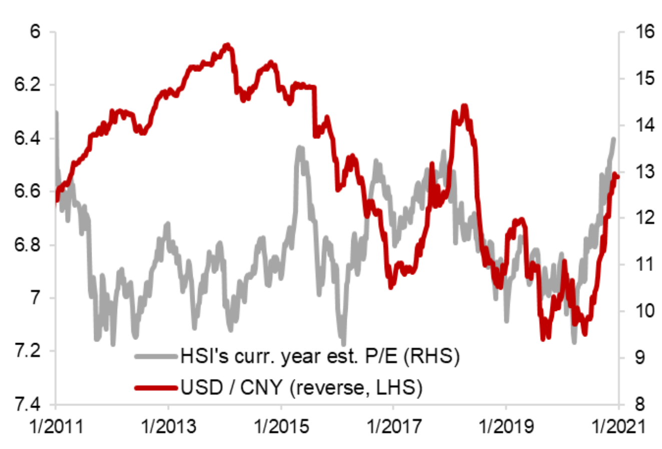
A weak USD is naturally lending support to the CNY strength (Fig. 6), which in turn bodes well for HK stock market's earnings and valuations (Fig. 7).

Figure 6: Strong CNY amidst USD weakness



Source: Bloomberg, CMBIS

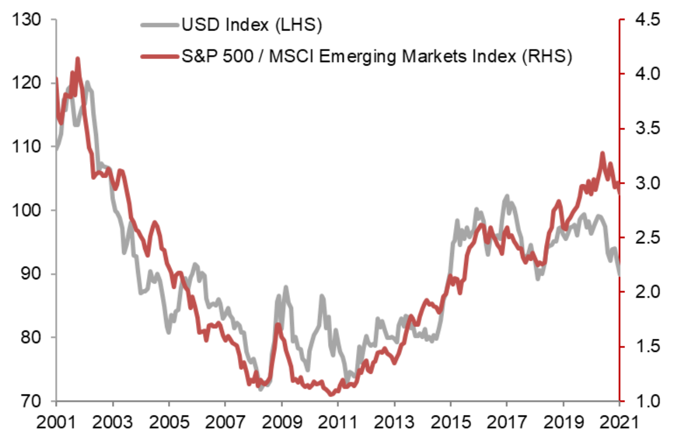
Figure 7: Strong CNY lifts HSI valuation



Source: Bloomberg, CMBIS

A weak USD usually bodes well for emerging markets' currencies and equities too. When USD weakens, EM equities tend to record net inflows and outperform U.S. equities (Fig. 8).

Figure 8: EM equity benefits from weak USD



Source: Bloomberg, CMBIS

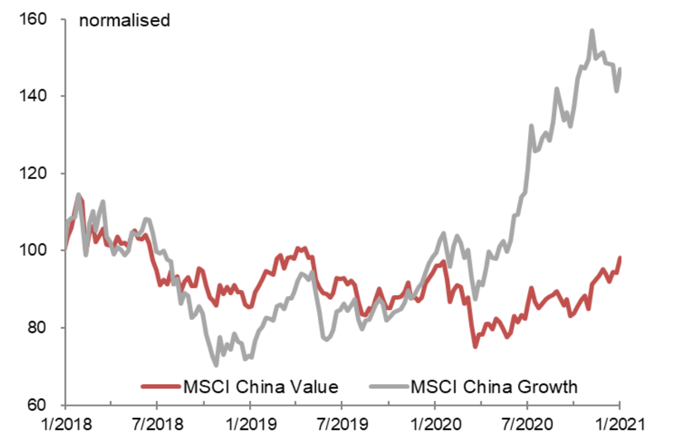
Sector rotation from Growth to Value goes on

Since late-2018, China's growth stocks have been significantly outperforming value stocks (Fig. 9). That outperformance went to extreme after the COVID-19 outbreak in Q1 2020, as cyclical, value stocks were the hardest hit by lockdowns and recession, while growth stocks were less vulnerable and even benefited to a certain extent.

Value stocks' discount at record high

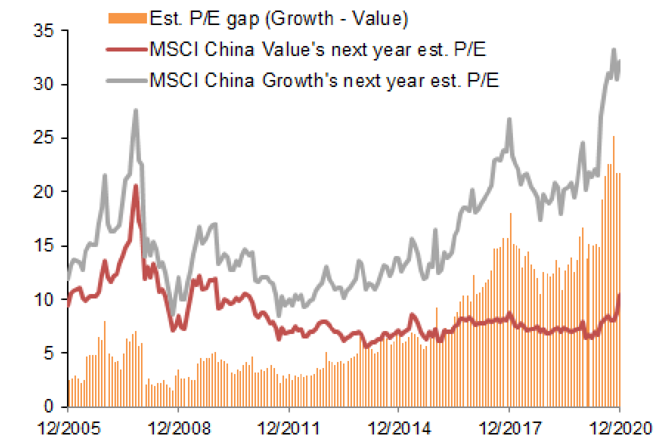
After such a dramatic divergence in performance, the valuation gap between China's value and growth stocks have surged to record-high (Fig. 10). With global economy under recovery and vaccines coming to market at a record pace strengthening investor confidence in economic outlook, such a wide valuation gap may well shrink, i.e. value stocks could turn the tide.

Figure 9: MSCI China Value vs Growth



Source: Bloomberg, CMBIS

Figure 10: Valuation gap of Value & Growth stocks



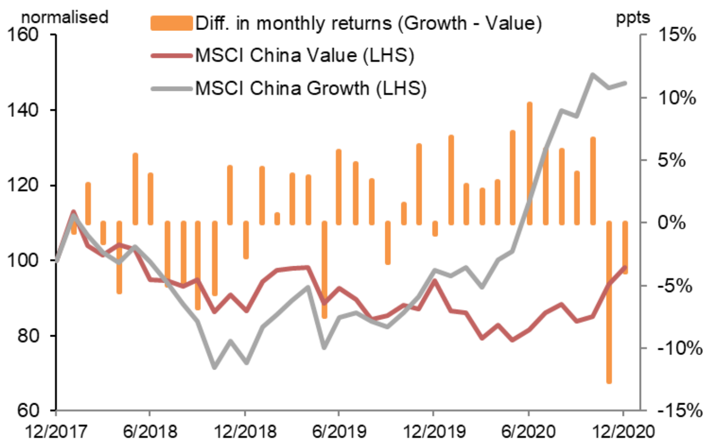
Source: Bloomberg, CMBIS

Value's catch-up could last for longer

Over the past 2-3 years, China's value stocks seldom outperformed growth for more than a month (Fig. 11). This time, however, value has outperformed in both Nov and Dec 2020. **We believe value would continue to outperform growth in Jan or even Feb 2021**, due to:

1) The case for global economic recovery is being strengthened by vaccine progress;
2) Valuation gap between value and growth stocks is still way larger than pre-pandemic peaks;
3) Low-base effect in terms of corporate earnings for value stocks in Q1;
4) Chinese internet giants, the biggest growth sector, are facing anti-monopoly policy risks.

Figure 11: Value playing catch-up for two months



Source: Bloomberg, CMBIS

Technical Analysis

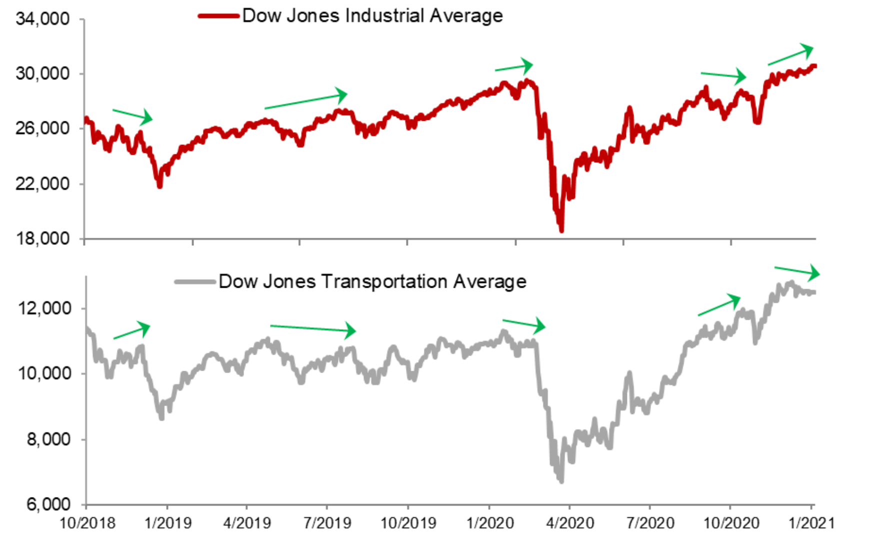
U.S. stocks poised for a correction?

The U.S. stocks kept surging to record highs in 2H 2020, climbing a wall of worry. But major U.S. stock indexes may be on the verge of a correction based on technical analysis.

According to the classic Dow Theory, **divergence of the Dow Jones Industrial Average and the Dow Jones Transportation Average is a warning sign** (not necessarily a "sell" signal). Since late-2018, such divergence, or so-called "non-confirmation" (the lagging index does not confirm the breakout in the leading index), have occurred at least four times, and a correction followed every time, including the pandemic-induced crash in Mar 2020.

Such "non-confirmation" happens again over the past four weeks (Fig. 12). **Get prepared for a short-term correction, although the magnitude is unknown, and medium-term upward momentum may well be intact.**

Figure 12: Dow Theory's non-confirmation signals



Source: Bloomberg, CMBIS

HSI bullish after breaking downtrends

- The Hang Seng Index has been rising for four straight days, **breaking the one-month downward channel**, with **MACD making a bullish crossover**, a "buy" signal (Fig. 13). While its RSI is close to overbought level, the experience in Nov 2020 showed that the HSI could keep creeping higher even when overbought.
- Longer-term, the **HSI has just broken the three-year downtrend** derived from all-time high in Feb 2018. Expect to maintain upward momentum in short-to-medium term, targeting 28,055 and 29,175, the peaks in Feb and Jan 2020 respectively (Fig. 14).

Figure 13: HSI broke downward channel; MACD signalled "buy"

Source: Bloomberg, CMBIS

Figure 14: HSI broke long-term downtrend resistance; targets 28,055 & 29,175

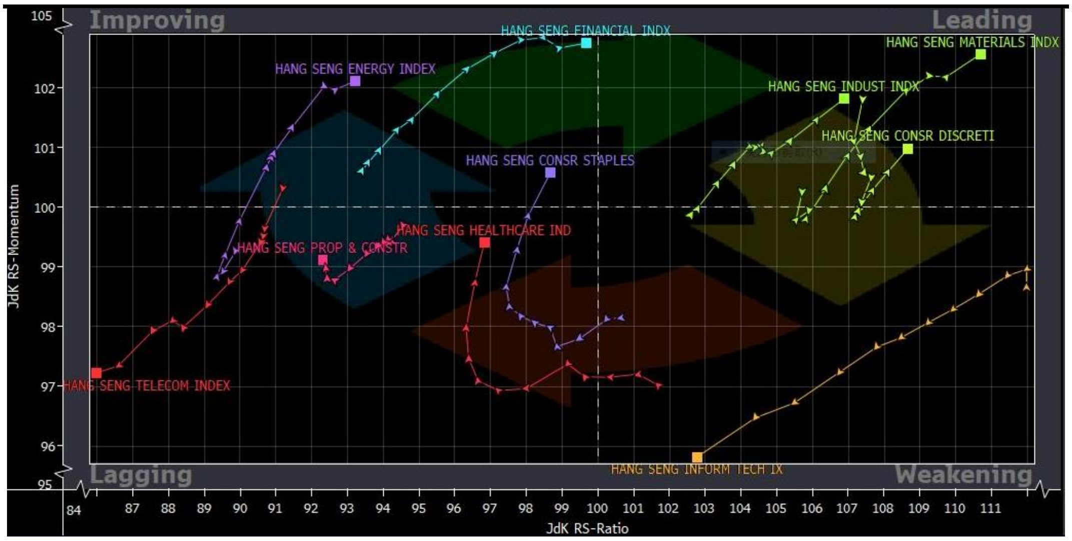
Source: Bloomberg, CMBIS

Cyclicals to maintain lead over Growth stocks

Relative Rotational Graph (RRG) of the Hang Seng Composite Index shows that **growth sectors in general are turning or have already turned weak**. Healthcare and Telecom are in the "lagging" zone for over two months. IT, the runaway leader in 2020, has been in "weakening" zone for three months. The RRG shows that Healthcare could be the first to be out of the woods, but Telecom and IT may stay week for longer.

On the contrary, **cyclical sectors are generally "leading" or "improving"**, with the exception of Property. Cyclicals were deep laggards in 2020, and the RRG shows they are **likely to keep leading in the coming weeks**.

Figure 15: Weekly Relative Rotational Graph of Hang Seng Composite Index



Source: Bloomberg, CMBIS

Strategy: Keep faith in Value & Policy stocks

In our Strategy Report on 10 Nov 2020 (link), we argued *"a sector rotation from growth to value is likely, and this rotation would last longer than previous ones."* Two months on, value stocks did outperform, and **we expect cyclical stocks, aka old-economy stocks, would continue to play catch-up in Jan**, as they are more sensitive to the reopening of economy and have a stronger earnings recovery.

On the contrary, **growth stocks, which have significantly outperformed in 2020, are expected to underperform in coming weeks**. In particular, **wait for a better entry point into internet stocks** as the sector's sentiment is being undermined by China's anti-monopoly policy risks.

Figure 16: Preferred sectors and stocks

Sector	Company	Ticker	Rating	Target Price (local currency)	Reason
Consumer	Moutai	600519 CH	BUY	2,153.3	Post-pandemic recovery; policies stress on boosting domestic consumption; leading consumer brands benefits from consumption upgrade; low-base effect in Q1 earnings;
	JS Global	1691 HK	BUY	19.57	
	Yum China	9987 HK	BUY	562.71	
	Pou Sheng	3813 HK	NR	NA	
Clean energy	China Gas	384 HK	BUY	37.12	Set to benefit from "peak carbon and carbon neutral" policy, as natural gas would play a key role in reducing coal consumption.
	Tian Lun Gas	1600 HK	BUY	8.31	
Capital goods	Zoomlion	1157 HK	BUY	10.50	Expect policy support for infrastructure spending. Zoomlion also benefits from recovery in property sales, and policies to modernize agricultural machinery.
Education	Hope Edu	1765 HK	BUY	3.41	The Central Economic Work Conference suggested to improve vocational education system, and relieve citizens' financial burden from education by increasing government spending.
Insurance	China Life	2628 HK	BUY	28.14	Insurers' investment income should rise along with a buoyant stock market and a rebound in bond yields. Insurance industry has more room for growth as penetration is still low. China Life's share price has been lagging behind recently.
Brokerage	CITIC Sec	6030 HK	BUY	24.60	Should benefit from a buoyant stock market. As market leader with a strong investment banking business, CITIC Sec is a key beneficiary of Mainland China's IPO reform.

Source: CMBIS

Risks

1. **COVID-19 variant and vaccine efficacy**

2. **U.S. Politics**:

   (i). **U.S. Senate election in Georgia on 5 Jan**. Two seats are up for grabs. If and only if Democrats win both seats, they will gain control of the Senate. As the Democratic Party already won the Presidency in Joe Biden and controls the House of Representatives, gaining control of the Senate would lead to a "Blue Wave". This may not be welcomed by investors, as that would mean Biden's policies such as raising corporate tax rates would be more easily passed in the Congress. Investors seem to prefer the Congress to remain split.

   (ii). **Presidential inauguration on 20 Jan**. We believe the market has somewhat priced in that U.S.-China relations would tend to moderate under Biden's reign, but Biden's administration would probably focus on reviving U.S. economy, and not roll back tariffs on China or other policies against China in the short term.

3. **USD rebound:** Much like in Aug 2020, the USD Index is showing signs of RSI-divergence. There is a possibility that the USD may rebound (or dead-cat bounce) in the short term, just like in Sep 2020, putting correction pressure on stocks, particularly EM.

Figure 17：USD Index showing RSI-divergence

Source: Bloomberg, CMBIS

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