

October Monthly Strategy

Favour visibility amid uncertainties

Three major factors could swing the market in the next few weeks, namely COVID-19, U.S. presidential election, and China's 5th Plenary Session. The first two bring uncertainties, and as such we would avoid sectors which are highly vulnerable to these risks. The remaining major factor is China's 5th plenary session, which we believe has much higher visibility and would be catalysts for certain policy-supportive sectors, such as consumer and clean energy.

- **COVID-19 - Second wave in Europe.** There has been a spike in new cases in Europe since late-Aug, with daily cases in the U.K. reached record high. Financial markets have not been reacting too negatively, and stocks may even rebound before daily new cases peak as stocks typically run ahead of fundamentals. That said, as the north hemisphere moves into winter, there are concerns over further resurgence in COVID-19 cases particularly in Europe and North America. Trends of new cases and news of vaccine development should be closely monitored.
- **U.S. Presidential Election - What if a repeat of the recount in 2000?** With just four weeks to go, investors will be keeping an eye on the U.S. election news. While Biden has been leading in polls, the election could be a close contest and the result may be decided by a few "swing states". The worst outcome for the market may be a repeat of the vote recount in 2000. During that five-week stand-off, S&P 500 plummeted by almost 10%.
- **China's 5th Plenary Session - Pre-meeting rally.** The 5th plenary session (五中全会) of the CPC will be held on 26-29 Oct. Key agenda includes setting the 14th Five-Year Plan and vision for 2035. Historical data suggest Chinese stocks tend to rise ahead of plenary sessions, and have mixed performance after the sessions.
- **Technical Analysis - HSI oversold, what's next?** The HSI fell to an oversold level on 24 Sep. We reviewed every occasion of the HSI's RSI falling to below 30 in the past decade. In short, after the HSI becomes oversold, the more likely outcome is that a short-term bottom is not far away, with only a moderate drawdown, but a strong rebound over the next month is not very likely either.
- **Strategy: Buy policy beneficiaries and internet giants.** China's 5th plenary session could be catalysts for certain policy-supportive sectors such as consumer and clean energy. Besides, we remain bullish on new-economy stocks over medium-to-long term for their strong growth potential. Among growth stocks, Chinese internet giants stand out with high earnings visibility.

Preferred sectors and stocks

Sector	Company
Internet	Tencent (700 HK), Meituan (3690 HK)
Technology	Luxshare (002475 CH), BYDE (285 HK)
Consumer	Anta Sports (2020 HK), Bosideng (3998 HK)
Clean Energy	China Gas (384 HK), Longyuan (916 HK)
Construction Machinery	Zoomlion (1157 HK), Jiangsu Hengli (601100 CH)

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Market Data

Hang Seng Index	23,768
52-week High / Low	29,175/21,139
3-month avg. daily t/o	HK\$139.3bn

Source: Bloomberg

Indices Performance

	HSI	HSCEI
1-month	-5.6%	-5.6%
3-month	-2.7%	-3.2%
6-month	3.0%	0.5%

Source: Bloomberg

12-month HSI Performance



Source: Bloomberg

Related Reports

1. Strategy Report – September Monthly Strategy: Dovish Fed and weak USD to lift HSI – 2 Sep 2020
2. Strategy Report – Tactical sector rotation to cyclicals – 19 Aug 2020
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There are three major factors that could swing the market in the next few weeks, namely COVID-19, U.S. presidential election, and China's 5th Plenary Session.

1. COVID-19

Second wave in Europe

There has been a spike in new COVID-19 cases in Europe since late-Aug, with daily case numbers in the U.K. reached record highs (Fig. 1). This second wave could be partly explained by the relaxation of public health and social measures, people dropping their guard, and increase in testing (some countries did not have the resources to carry out large-scale tests earlier this year).

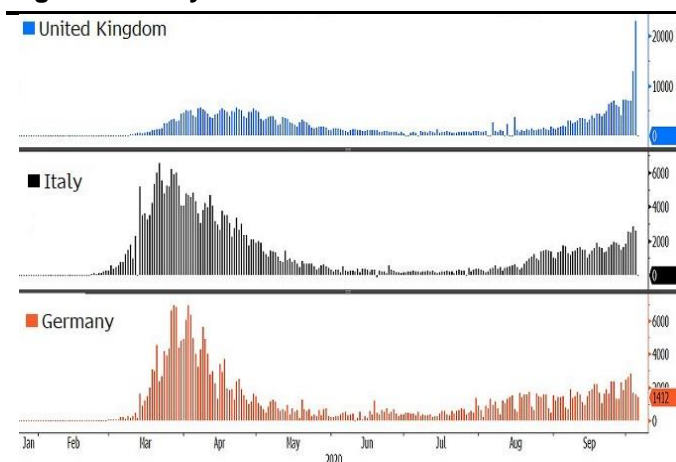
Financial markets have not been reacting too negatively to this second wave of outbreak, with the U.K. stock market moving sideways over the past few weeks, and Germany and France's markets down by a few percent. Such resilience may stem from governments' reluctance to reimpose stringent lockdown measures, and thus the negative impact on the economy should be limited.

■ Stocks may rebound before daily new cases peak

Since markets typically run ahead of fundamentals, stocks may even rise before daily new cases peak out, if the U.S. market is any guide. As illustrated in Fig. 2, in March when the U.S. experienced its first outbreak in March, U.S. stocks bottomed weeks before daily cases dropped. The same was true for the second wave in June and the most recent one in Sep.

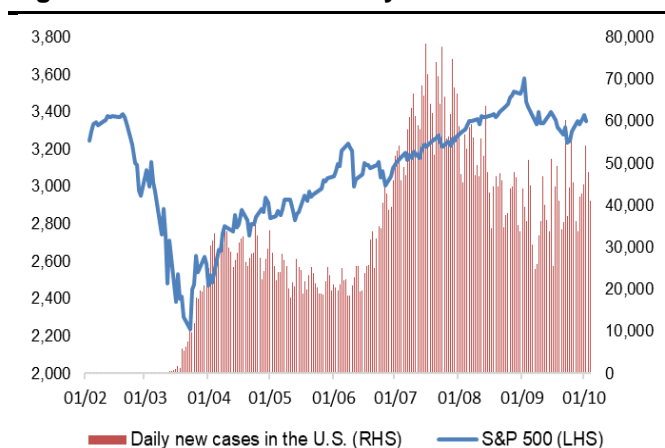
Having said that, as the north hemisphere moves into winter, there are concerns over further resurgence in COVID-19 cases particularly in Europe and North America. **If a second / third / nth wave does occur in major economies, equities, especially cyclicals, will likely go under pressure.** Trends of new cases and news of vaccine development should therefore remain one of the key factors.

Figure 1: Daily new COVID-19 cases in EU and U.K.



Source: Bloomberg, CMBIS

Figure 2: U.S. stocks vs. daily new COVID-19 cases



Source: Bloomberg, CMBIS

2. U.S. Presidential Election

Trump tested positive for COVID-19

The U.S. presidential election is scheduled on 3 Nov 2020. With just four weeks to go, investors will be keeping an eye on relevant news. Comparing the two candidates, President Donald Trump is widely regarded as more pro-business and taking a hard line on China, while Democratic nominee Joe Biden vowed to raise taxes and is believed to be more friendly to China. Simply put, a Trump re-election may be more positive to U.S. stocks and negative to China/HK stocks, and the reverse is true for a Biden victory.

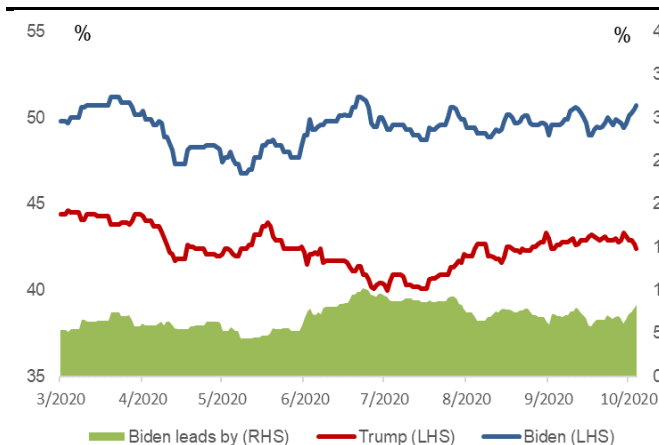
The news that Trump was tested positive for COVID-19 on 1 Oct brought some volatility to the markets, and may add uncertainties in two ways. Firstly, will that change voters' support for Trump? Secondly, will Trump administration takes an even harder stance on China?

Election polls will be closely tracked. Joe Biden has been leading throughout (Fig. 3), and his lead widened after his first television debate with Trump on 29 Sep. Two more debates are scheduled to take place on 15 & 22 Oct.

■ What if a repeat of the recount in 2000?

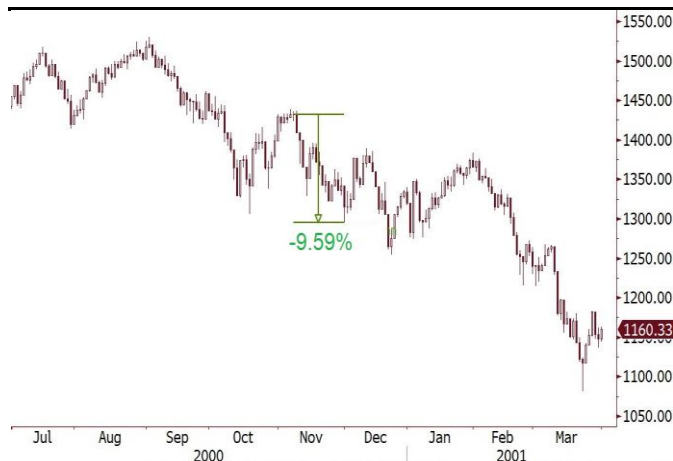
Despite Biden's lead in polls, many believe the election will be a close contest and the result will be decided by a few "swing states". **The worst outcome for the market may be a repeat of the vote recount in 2000.** Recall that in the 2000 presidential election, George W. Bush defeated Al Gore by a thin margin, but not until five weeks after the election day (7 Nov 2000) as the votes in Florida were so close that state law required a recount. During the stand-off, S&P 500 plummeted by almost 10% (Fig. 4).

Figure 3: Joe Biden's lead widening again



Source: RealClearPolitics, Bloomberg, CMBIS

Figure 4: S&P 500 during 2000 vote recount



Source: Bloomberg, CMBIS

3. China's 5th Plenary Session

Pre-meeting rally expected

For Hong Kong and Mainland China stock markets, policy is another focus in October. The 5th plenary session (五中全会) of the 19th Central Committee of the Communist Party of China will be held in Beijing during 26-29 Oct. Key agenda includes setting the 14th Five-Year Plan on economy and social development, and vision for 2035.

Historical data suggest that Chinese stocks tend to rise ahead of plenary sessions, and have mixed performance after the sessions (Fig. 3). In fact, if we exclude the 3rd plenary session starting on 9 Oct 2008 which coincided with the Global Financial Crisis, H-shares on average rose in the 2-week and 3-week periods before the 3rd, 4th and 5th Plenary Sessions. We focus on the 3rd, 4th, and 5th (but not the 1st, 2nd, 6th or 7th) plenary sessions because they are centred around economic and development policies, and thus have more direct impact on stocks.

Figure 5: A & H shares pre- and post- CPC Plenary Sessions

Meeting's opening date	3 weeks PRIOR		2 weeks PRIOR		3 weeks AFTER		2 weeks AFTER	
	HSCEI	SHSZ300	HSCEI	SHSZ300	HSCEI	SHSZ300	HSCEI	SHSZ300
5th Plenary on 26 Oct 2015	10.9%	11.5%	3.2%	6.9%	-3.2%	-1.0%	-1.7%	6.2%
5th Plenary on 15 Oct 2010	11.3%	12.8%	9.2%	12.2%	2.7%	8.0%	-1.8%	5.4%
5th Plenary on 8 Oct 2005	-0.1%	-5.2%	0.9%	0.1%	-6.8%	-5.4%	-3.5%	-1.4%
Average	7.4%	6.4%	4.4%	6.4%	-2.4%	0.5%	-2.4%	3.4%
4th Plenary on 28 Oct 2019	4.2%	2.3%	0.6%	-0.7%	-0.4%	-0.5%	4.0%	2.0%
4th Plenary on 20 Oct 2014	-3.3%	0.2%	-1.1%	0.2%	3.0%	2.5%	5.1%	2.7%
4th Plenary on 15 Sep 2009	3.9%	2.0%	7.8%	16.4%	-4.2%	-8.8%	-3.3%	-9.7%
4th Plenary on 16 Sep 2004	3.0%	1.0%	-0.2%	2.5%	10.8%	6.2%	4.5%	5.4%
Average	1.9%	1.4%	1.8%	4.6%	2.3%	-0.2%	2.6%	0.1%
3rd Plenary on 26 Feb 2018	-5.9%	-4.7%	7.0%	6.0%	-0.5%	-0.4%	-2.4%	0.9%
3rd Plenary on 9 Nov 2013	-2.4%	-4.9%	2.1%	-2.6%	10.1%	5.7%	10.2%	3.9%
3rd Plenary on 9 Oct 2008	-14.0%	4.9%	-23.4%	-5.4%	-22.4%	-18.0%	-10.1%	-9.4%
3rd Plenary on 11 Oct 2003	21.6%	0.5%	13.8%	2.1%	3.3%	-2.4%	-1.1%	-1.3%
Average	-0.2%	-1.0%	-0.1%	0.0%	-2.4%	-3.8%	-0.9%	-1.5%

Source: Bloomberg, CMBIS

In this year's 5th plenary session and the 14th Five-Year Plan, the central government could emphasise "dual circulation" and "carbon neutrality" among other policies. That is, expect supportive policies for domestic consumption and renewable / clean energy.

USD & CNY trend intact

In addition to the abovementioned key factors, currency movement could be another driver or gauge of stock market.

The USD has been on a downtrend for the past six months, due to rising risk appetite and aggressive easing by the Fed (zero interest rate, unlimited QE, targeting average inflation and thereby pledging zero rate for several years). The dollar did rebound in Sep, but could be no more than a short-term technical bounce (Fig. 6). **If the Dollar Index dropped to below 93.5 again, that could signal a relapse into downtrend, which bodes well for stocks, especially emerging markets.**

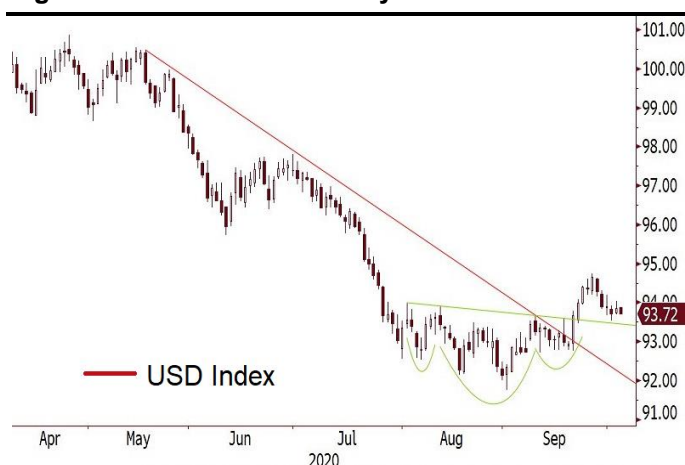
■ Easing QDII / RQFII access may support CNY

On the contrary, **the Chinese yuan has been appreciating since Jun**, backed by moderate economic recovery and relatively conservative monetary policy. A recent policy move may lend more support to the yuan over the long run.

The CSRC, PBoC and the State Administration of Foreign Exchange (SAFE) recently announced finalised “measures for the Administration of Domestic Securities and Futures Investment by Qualified Foreign Institutional Investors (QFII) and the RMB Qualified Foreign Institutional Investors (RQFII)” which will be effective from 1 Nov. The measures will lower entry requirements, simplify procedures for institutional investors to access China’s capital markets, and broaden investable scope.

A strong yuan typically bodes well for H-shares’ valuation and sentiment, especially for yuan asset-heavy sectors such as financials and property, and sectors with heavy foreign currency debt or expense such as airlines and papers.

Figure 6: USD’s rebound may be short-lived



Source: Bloomberg, CMBIS

Figure 7: CNY remains in uptrend

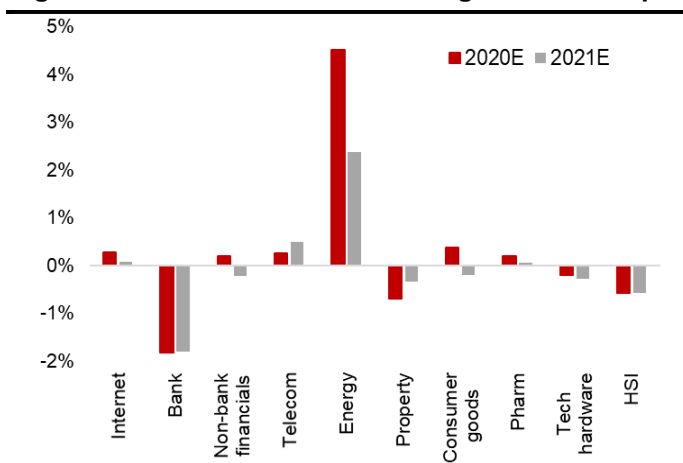


Source: Bloomberg, CMBIS

HK stocks' earnings trend and valuation

Over the last month (since changes in HSI constituent stock on 7 Sep), consensus earnings of the HSI were revised downward by 0.6% for both 2020 and 2021. If we break down the HSI constituent stocks into sectors, earnings revisions were quite mixed, with cuts in banks and property, but the biggest jump was on energy, another old economy sector. Growth stocks such as internet and consumer goods in general enjoyed modest upward revisions.

Figure 8: HSI and sector EPS changes since 7 Sep



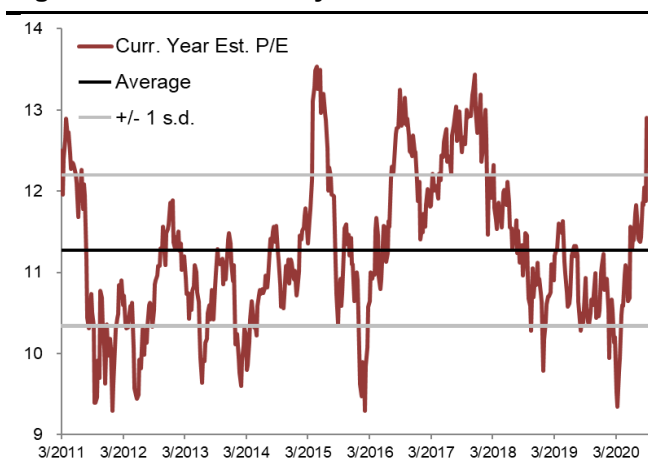
Source: Bloomberg, CMBIS

Higher growth comes at a price

On the face of it, the HSI's valuation seems a bit stretched compared to historical levels. Its current year's estimated P/E stands at 12.6X, more than 1 s.d. over its 10-year average 11.3X (Fig. 9). This multiple has been driven up by new constituents **Alibaba (9988 HK)**, **Xiaomi (1810 HK)** and **Wuxi Bio (2269 HK)**, which in total make up of ~10.8% of the HSI.

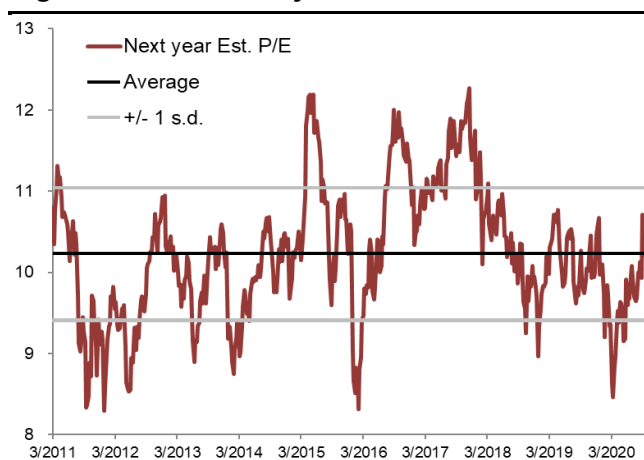
As HSI's earnings growth is also boosted by these growth stocks, 2021E P/E are more "reasonable", with next year's estimated P/E at 10.4X, slightly higher than 10-year average 10.2X (Fig. 10).

Figure 9: HSI's current year estimated P/E



Source: Bloomberg, CMBIS

Figure 10: HSI's next year estimated P/E



Source: Bloomberg, CMBIS

Technical Analysis

HSI oversold, what's next?

The HSI has formed a bearish “head and shoulder” pattern in Aug-Sep. The neckline 24,100 has been broken, and become a short-term resistance.

The HSI fell to an oversold level on 24 Sep (14-day RSI below 30) (Fig. 11). Would that foresee a prolonged downtrend, or quite the contrary, an imminent rebound?

Figure 11: HSI fell to downward channel while RSI sank below 30



Source: Bloomberg, CMBIS

Figure 12: HSI's performance after RSI reached <30

Date RSI (14) dropped below 30	Subsequent drawdown	Trading days taken to recover loss	1-month return since oversold
24 Sep 2020	???	???	???
9 Mar 2020	-13.3%	62	-3.0%
2 Aug 2019	-6.1%	28	-4.8%
21 May 2019	-3.2%	14	3.0%
11 Oct 2018	-2.7%	14	1.5%
27 Jun 2018	Toughed on the same day		1.6%
9 Feb 2018	-0.2%	2	5.0%
20 Dec 2016	-0.7%	4	5.3%
7 Jan 2016	-9.9%	44	-8.8%
18 Aug 2015	-12.3%	268	-6.6%
7 Jul 2015	-2.3%	4	-1.7%
11 Mar 2015	Toughed on the same day		18.1%
29 Sep 2014	-1.3%	3	2.5%
27 Jan 2014	-3.2%	10	3.9%
7 Jun 2013	-8.2%	31	-4.6%
16 May 2012	-5.6%	23	0.9%
22 Sep 2011	-9.3%	12	4.8%
8 Aug 2011	-5.7%	17	-2.8%
16 Jun 2011	-1.6%	6	-0.7%
Average	-4.8%	30	0.8%

Source: Bloomberg, CMBIS

In Fig. 12, we reviewed every occasion of the HSI's RSI falling to below 30 in the past decade. On average, the HSI would drop a further 4.8% after becoming oversold, and took 30 trading days to rise back to the levels before oversold (would be 16 days if the outlier in Aug 2015 is excluded). One month after becoming oversold, average return is +0.8%.

In short, **after the HSI becomes oversold, the more likely outcome is that a short-term bottom is not far away, with only a moderate drawdown, but a strong rebound over the next month is not very likely either.**

Strategy: Favour visibility amid uncertainties

Among the three major factors that we discussed, COVID-19 and U.S. presidential election bring uncertainties, and as such we would **avoid sectors which are highly vulnerable to these risks, including oil, base metals, airlines, shipping and exporters.**

The remaining major factor is **China's 5th plenary session, which we believe has much higher visibility.** China's President Xi Jinping raised the idea of "dual circulation" that China will rely mainly on "internal circulation" - the domestic cycle of production, distribution, and consumption. On clean energy, President Xi pledged to go carbon neutral by 2060 and reach peak emissions by 2030. We believe **these policies will be reiterated and could be catalysts for relevant sectors such as consumer and clean energy.**

Besides, we believe **investors would still favour new-economy stocks** over medium-to-long term for their strong growth potential. Among growth stocks, **Chinese internet giants have high earnings visibility** given most of their income are from domestic market (overseas income mix <10%).

Figure 13: Preferred sectors and stocks

Sector	Company	Ticker	Rating	Target (local currency)	Reason
Internet	Tencent	700 HK	BUY	624	Internet giants stand out with strong growth outlook & high visibility. Less vulnerable to U.S.-China relations than hardware stocks.
	Meituan	3690 HK	BUY	290	
Technology	Luxshare	002475 CH	BUY	74.20	Set to benefit from Apple's new product cycle (Luxshare has 67% rev. from Apple in 2021E; BYDE would have rapid share gain with Apple/Xiaomi). Expect positive sentiment ahead of new iPhone launch in Oct.
	BYDE	285 HK	BUY	37.7*	
Consumer	Anta Sports	2020 HK	BUY	101.84	Benefits from "dual circulation" policy which boosts domestic consumption. Retail is enjoying strong recovery following a pandemic-hit 1H.
	Bosideng	3998 HK	BUY	3.26	
Clean energy	China Gas	384 HK	BUY	37.12	Set to benefit from "14 th Five-Year Plan" which is expected to revise up the target mix of non-fossil fuel and support clean energy in general.
	Longyuan	916 HK	BUY	7.38	
Construction Machinery	Zoomlion	1157 HK	BUY	11.2	Expect policy support for infrastructure spending. Zoomlion also benefits from property sales recovery. Hengli would emerge as one of the few China-based global tier-one players in hydraulic component industry, driven by import substitution.
	Jiangsu Hengli	601100 CH	BUY	82.0	

Source: CMBIS

* Target price under review

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