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Strategy Report

"Two sessions" preview and what to buy

The NPC & CPPCC meetings of the PRC ("two sessions") are scheduled to kick off on 22 & 21 May respectively. We preview potential policies, from fiscal, monetary to targeted stimuli. We expect consumer stocks would emerge as winners, supported by policies as well as historical data. Capital goods is another sector expected to outperform.

- **Broad consumption support & targeted investment boost.** Monetary easing and fiscal stimuli have been frontloaded before the "two sessions" to mitigate negative impacts of the COVID-19. However, there are still plans that haven't been specified yet, such as the annual goal of achievements, the magnitude of fiscal stimuli, and stepped-up measures to support SMEs and most affected populations, etc. These could be market focus during the two sessions. We expect the government will continue beefing up demand and consumption support, which could be broad-based, while investment boost and employment support would be more targeted.
- **Consumer sectors may again be the winner this year.** With the pandemic and US-China relations currently the key swing factors on the broad market, we may focus on two sessions' impact on sectors' relative performance. Historical data suggest that consumer sectors tended to outperform around the two sessions, and we expect the same this year having considered policy support and external risks. Consumer stocks that may outperform include retail, catering, auto, education, e-commerce, etc.
- **Capital goods**: Infrastructure spending will continue to be the key measure to support the economy. Expect approval of more projects following the two sessions. We see upside in demand for construction machinery and heavy-duty truck in 2H20E.

Stocks which may benefit from "two sessions"

Sector	Company
Capital Goods	SANY Heavy (600031 CH), Jiangsu Hengli (601100 CH), Zoomlion (1157 HK, 000157 CH), Sinotruk (3808 HK), Weichai Power (2338 HK, 000338 CH), Zhejiang Dingli (603338 CH)
Consumer Discretionary	Jiumaojiu (9922 HK), Haidilao (6862 HK), Anta (2020 HK), Li Ning (2331 HK), Xtep (1368 HK), Midea (000333 CH), JS Global (1691 HK)
Consumer Staples	CR Beer (291 HK), Tsingtao Brewery (168 HK)
Education	Hope Edu (1765 HK), China Edu (839 HK), Yuhua Edu (6169 HK), Minsheng Edu (1569 HK), Kepei (1890 HK)
Auto	GAC Group (2238 HK), Geely Auto (175 HK)
Internet	Alibaba (BABA US), Meituan-Dianping (3690 HK), Pinduoduo (PDD US), Tongcheng-Elong (780 HK)

Source: CMBIS

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China Economy – What to expect at the “two sessions”?

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Although the NPC & CPPCC meetings (“two sessions”) were postponed from early Mar to late May this year, policy reactions were fast and precise to mitigate negative impacts of the COVID-19 and stabilize economic development. Monetary easing and fiscal stimuli have been frontloaded before the “two sessions”, so have been industry policies and open-up and reform initiatives in search for new growth engines.

That said, we think by and large, policy directions and tones have already been set and anticipated by the market. However, there are still plans that haven’t been specified yet, such as the annual goal of achievements, the magnitude of fiscal stimuli, and stepped-up measures to support SMEs and most affected populations, etc. These could be market focus during the two sessions.

Economic targets

Annual economic growth targets are multi-fold, which used to include GDP growth, CPI, urban new employed population, unemployment rate, and change in energy consumption per GDP, and etc.

Will the government set GDP growth target in 2020? We think instead of a specific range (i.e. 6.0-6.5% in 2019), this year’s goal is likely to be loosely defined accounting for the fact that GDP declined 6.8% in 1Q. For example, the goal may only include targeted range of growth for 2H20 to encourage recovery.

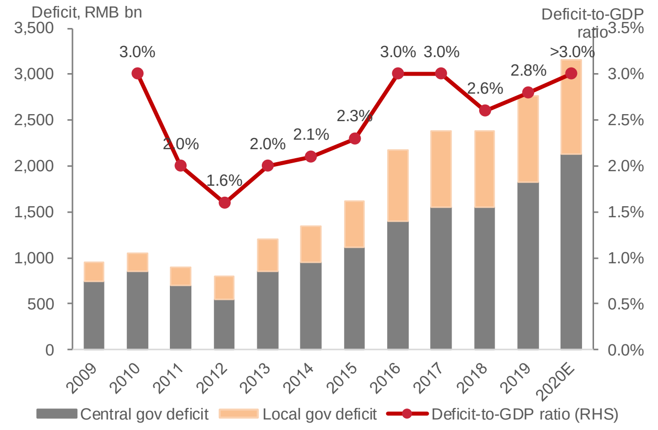
Fiscal stimuli

The amount of fiscal stimuli is to be specified in the government work report, involving the following three aspects.

1) Fiscal deficit ratio

Due to a decline in fiscal revenue and expanding expenditures, we estimate fiscal deficit ratio may exceed 3.0% in 2020.

Figure 1: Estimated fiscal deficit ratio exceeds 3.0% in 2020E



Source: Ministry of Finance, Wind, CMBIS

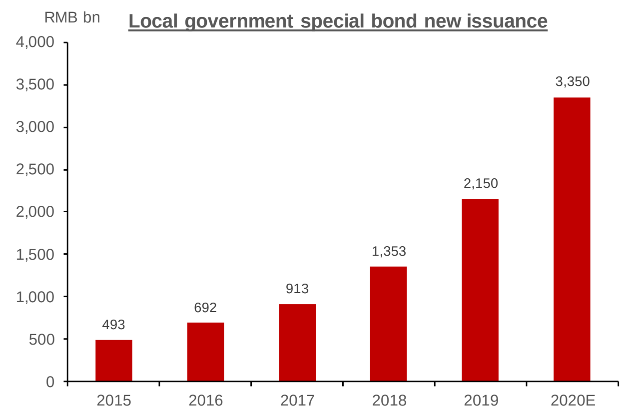
2) Special treasury bond

Much remained unknown regarding when to issue, how much, what to use it for, etc. Back in history, special treasury bond was issued twice, once in 1998 to enhance capital position of the "Big 4" banks (RMB 270bn) and the other in 2007 to fund initial capital for CIC (RMB 1.55tn). This time, special treasury bond could come in the form of enhancing banks' capital position or providing loan guarantees for affected SMEs who borrow from banks.

3) Local government special bond (LGSB)

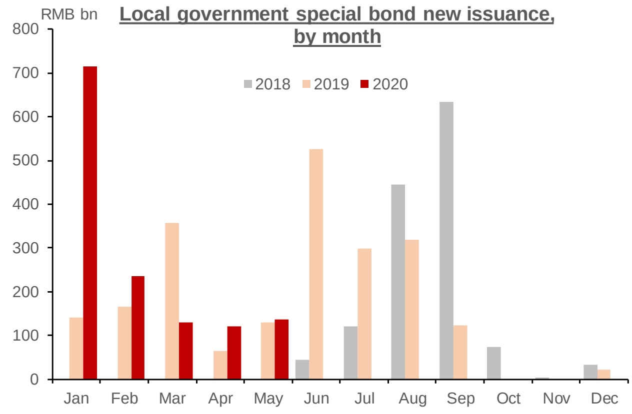
We estimate that RMB 3.35tn LGSB will be issued this year (vs. RMB 2.15tn in 2019) in order to speed up infrastructure investment. Three batches of LGSB have already been frontloaded, totalling RMB 2.85tn.

Figure 2: LGSB issuance estimated at RMB 3.35tn



Source: Ministry of Finance, CMBIS estimate

Figure 3: Frontloading of LGSB issuance in 2020



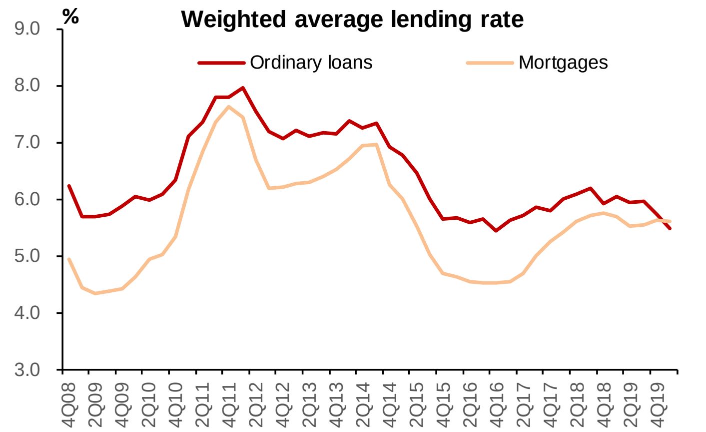
Source: Ministry of Finance, CMBIS
Note: As of 15 May 2020

Monetary policies

Since the outbreak of COVID-19, monetary policies have proved effective in both volume and price of lending. Total social financing (TSF) increased RMB 14.2tn in Jan-Apr 2020, vs. RMB 10.2tn in the same period last year. Among this, new RMB loans increased RMB 8.8tn. Meanwhile, average lending rate for ordinary loans edged down 26bp from YE19.

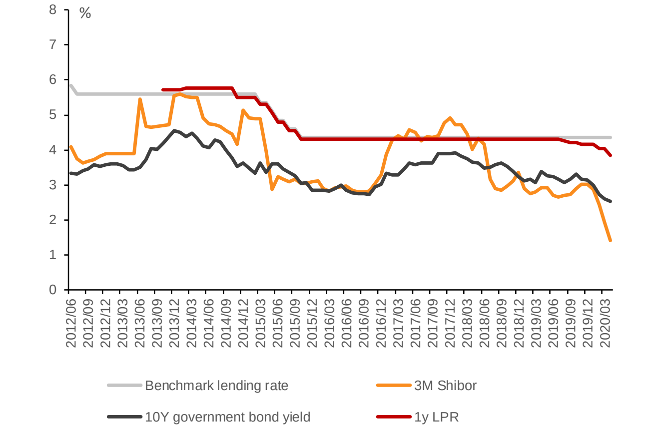
Structural and targeted easing is likely to be the theme of monetary policies going forward to ensure lending to SMEs. Regulatory authorities shall pay more attention to smaller banks, which are an important channel for SME financial support but may need extra support in loan guarantee, capital position enhancement, and etc.

Figure 4: Weighted average lending rate for ordinary loans went down 26bp from YE19



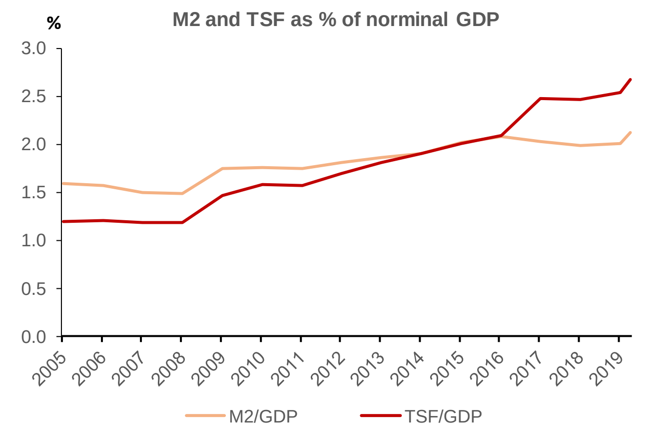
Source: PBoC, Wind, CMBIS

Figure 5: Interest rates have been guided down



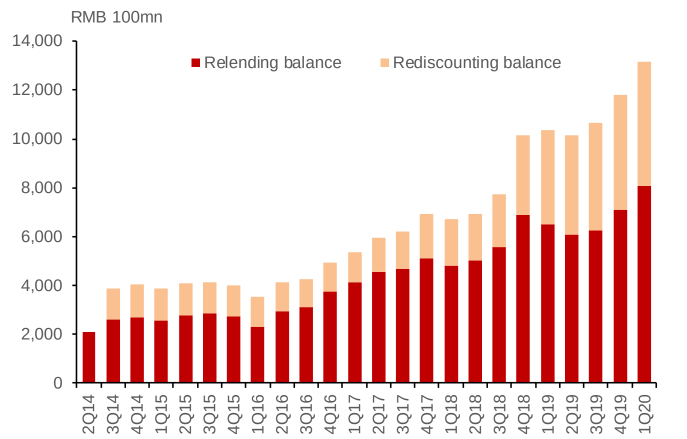
Source: PBoC, Wind, CMBIS

Figure 6: Surging TSF and M2 since 2020



Source: PBoC, NBS, Wind, CMBIS

Figure 7: Relending and rediscounting balance



Source: PBoC, Wind, CMBIS

Expand domestic demand

Although the economy has embarked on recovery, demand-side rebound is weaker than the supply side. Consumption and retail sales growth followed a shallower path of recovery, and are likely to be weighed on by slack wage growth or a rise in unemployment.

Therefore, we expect government will continue beefing up **demand and consumption support**. Measures may include 1) increase public sector consumption to trigger private sector demand; 2) continue to encourage purchase of big-ticket items, such as cars and household appliances by offering subsidies or tax cuts; 3) distribute coupons to affected populations or to help most affected industries.

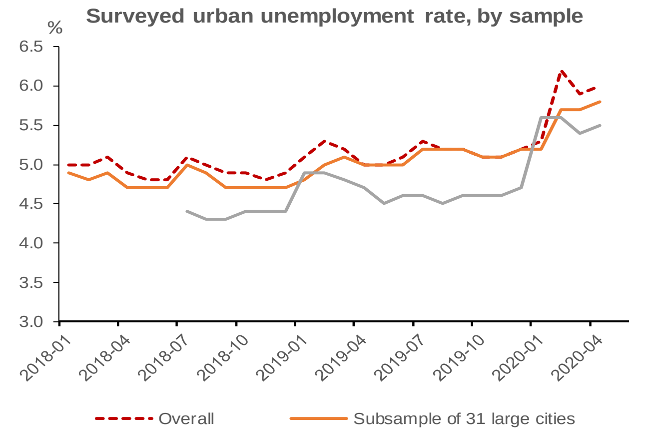
Targeted investment boost

While consumption boost could be broad, we believe the government will overweigh investment in the selected areas, 1) high-tech and high-end manufacturing, 2) new infrastructure, 3) areas related to people's livelihood, for example, hospitals, healthcare, education, elderly care, etc. and 4) industries related to supply chain safety.

More stimulus to stabilize employment

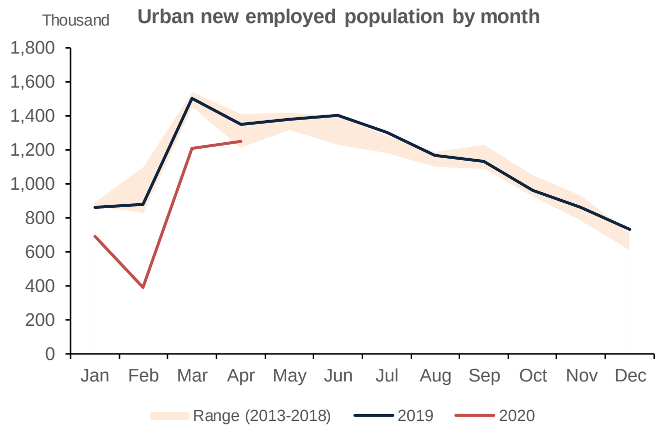
The government has already rolled out comprehensive support to stabilize employment. Going forward, we think supports should be more targeted and precise. Employment situation is tougher with respect to the service sector, export-oriented manufacturing industries, private companies, SMEs, low-income and low-skilled population. Future job support is expected to tilt towards these industries, firms and populations.

Figure 8: Urban surveyed unemployment rate reached 6.0% in Apr 2020



Source: NBS, Wind, CMBIS

Figure 9: Urban employed population added 3.54 million in Jan-Apr 2020 (4.59 million in Jan-Apr 2019)



Source: Baidu, CMBIS

Hong Kong Stock Market – Which sectors may outperform?

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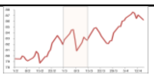
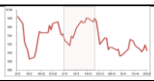
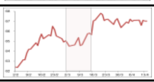
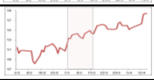
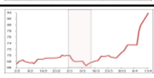
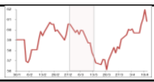
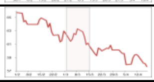
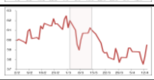
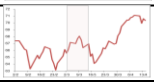
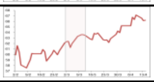
Clues from the past

"History doesn't repeat itself but it often rhymes." We reviewed the performance of China stock market and major sectors (MSCI China and its sub-indexes) before, during and after NPC sessions in each of the last ten years, so as to find clues of what to expect in the next few weeks.

Figure 10: MSCI China's performance before, during and after NPC sessions in the past decade

	MSCI China		MSCI China	IT	Comm Serv	Cons Disc.	Cons Stap.	Financials	Materials	Real Estate	Healthcare	Industrial
2019		1m after	3.5%	2.9%	3.9%	3.3%	11.3%	1.3%	7.0%	-1.2%	8.2%	3.1%
		During NPC	0.7%	-0.6%	5.0%	-1.2%	0.2%	-1.5%	-3.8%	0.3%	1.0%	-2.5%
		1m before	4.2%	15.5%	-1.8%	9.2%	4.1%	6.0%	8.0%	3.2%	4.5%	4.1%
2018		1m after	-7.7%	-12.3%	1.7%	-12.0%	4.6%	-6.0%	-1.0%	8.7%	-8.2%	-4.2%
		During NPC	5.5%	7.7%	0.0%	4.3%	-1.0%	4.3%	2.1%	2.0%	16.2%	0.3%
		1m before	-5.6%	-2.0%	-10.8%	-1.3%	2.3%	-10.3%	-6.2%	-13.5%	-1.5%	-5.9%
2017		1m after	2.1%	4.9%	2.6%	1.7%	-3.2%	-2.0%	-0.2%	7.2%	2.4%	1.1%
		During NPC	1.3%	2.0%	-1.6%	3.0%	0.2%	0.7%	-1.3%	-3.2%	0.3%	1.2%
		1m before	3.9%	2.1%	-2.3%	8.1%	1.5%	7.4%	3.8%	-3.3%	4.7%	5.4%
2016		1m after	7.6%	7.4%	5.6%	9.0%	15.3%	5.7%	6.7%	9.0%	10.7%	12.2%
		During NPC	1.6%	2.0%	0.8%	1.5%	-0.6%	2.6%	-0.2%	1.0%	-2.7%	1.0%
		1m before	3.7%	3.9%	0.8%	0.1%	-2.0%	3.0%	23.3%	12.3%	5.8%	4.1%
2015		1m after	24.0%	24.9%	13.0%	26.2%	15.5%	24.7%	35.9%	19.4%	24.6%	45.3%
		During NPC	-3.5%	0.1%	-5.1%	-0.5%	-4.8%	-3.8%	-3.1%	-6.5%	0.6%	-3.5%
		1m before	4.0%	4.0%	2.2%	7.9%	-1.0%	5.5%	4.3%	4.9%	-3.3%	4.2%
2014		1m after	6.0%	-7.4%	7.5%	8.2%	3.8%	9.3%	12.3%	11.1%	-11.5%	4.9%
		During NPC	-5.2%	-4.7%	-5.4%	-6.7%	-1.7%	-5.6%	-5.5%	-6.7%	0.3%	-4.5%
		1m before	2.6%	10.4%	-1.1%	3.2%	4.1%	-1.1%	-1.2%	6.3%	6.7%	2.8%
2013		1m after	-5.0%	-10.2%	-3.5%	-4.6%	-1.7%	-4.2%	-6.0%	-8.7%	-3.9%	-5.4%
		During NPC	-3.1%	-0.9%	-2.1%	-6.1%	0.6%	-3.9%	-7.0%	-1.4%	4.4%	-6.0%
		1m before	-4.7%	0.5%	-2.0%	-6.2%	-1.8%	-7.0%	-4.1%	-6.4%	2.8%	-2.3%
2012		1m after	-2.5%	7.6%	-1.0%	-4.1%	-4.0%	-2.0%	-3.3%	-6.1%	-3.4%	-3.3%
		During NPC	-1.6%	-0.3%	1.9%	1.4%	6.7%	-4.2%	-5.6%	-1.4%	2.8%	-3.1%
		1m before	3.4%	7.5%	1.9%	6.6%	1.9%	2.8%	7.2%	1.3%	7.4%	5.5%
2011		1m after	5.1%	-4.3%	0.7%	4.5%	7.9%	6.5%	8.2%	7.3%	1.6%	3.5%
		During NPC	2.0%	3.3%	0.7%	-0.1%	2.6%	2.3%	3.3%	2.2%	-1.0%	1.9%
		1m before	-2.6%	0.3%	-3.3%	-3.8%	-3.1%	-1.6%	-2.8%	-2.5%	0.5%	-7.5%
2010		1m after	4.3%	2.5%	5.7%	3.7%	0.0%	5.4%	2.1%	4.8%	12.5%	1.0%
		During NPC	1.8%	2.5%	-1.5%	4.4%	5.9%	1.3%	1.6%	3.4%	1.6%	2.7%
		1m before	4.0%	7.7%	2.9%	3.3%	1.6%	5.1%	1.6%	4.3%	5.1%	2.3%

Shaded area = During NPC

Colour key: Outperformed | Slightly Outperformed | Market-performed | Slightly Under-performed | Under-performed

Source: Bloomberg, CMBIS

- **Broad market:**

  a. During NPC sessions, the market usually whipsawed with lower volatility than before and after the session.

  b. Had >50% probability of positive return before, during and after NPC sessions, but difficult to find a clear trend and make any forecast with high conviction.

- **Sectors:**

  a. **Consumer (Discretionary or Staples), Healthcare and IT** (mainly composed of hardware like handset equipment makers, which is partly consumer-driven too) **tended to outperform the broad market,** possibly because NPC sessions often stressed on *"structural economic reform", "boost domestic consumption", "improve social welfare".*

b. **Financials rarely outperformed**, as NPC sessions in recent years vowed to *"deleverage"*, and pushed for *"supply-side reform"*.

Consumer sectors may again be the winner this year

With the COVID-19 pandemic and arguably US-China relations the top swing factors in the market currently, it may be more difficult than ever to predict the broad market's direction based on the NPC session factor.

Instead, we may focus on sectors' relative performance. **Expect Consumer sectors to outperform again**, due to 1) bets on more policy stimuli, 2) domestic demand starting to recover, while external demand is still weak as the outbreak in major developed countries have only been gradually controlled, while many other developing countries are still at early stage of outbreak, 3) less exposed to risk of escalating US-China tension. We use "Consumer sectors" here in a broad sense to cover **retail, catering, auto, education, e-commerce, etc**.

IT sector (hardware), however, is less likely to repeat its outperformance this year, as it is more vulnerable to external risks, namely sluggish demand and US-China tension.

In the following pages, our analysts of relevant sectors lay out how the "two sessions" could benefit each sector, and which stocks may emerge as winners.

Figure 11: Stocks which may benefit from "two sessions"

Sector	Company	Ticker	Rating	TP (local currency)
Capital Goods	SANY Heavy	600031 CH	BUY	23.50
	Jiangsu Hengli	601100 CH	BUY	85.00
	Zoomlion	1157 HK, 000157 CH	BUY	HK$6.90, RMB 6.85
	Sinotruk	3808 HK	BUY	20.50
	Weichai Power	2338 HK, 000338 CH	BUY	HK$16.00, RMB 14.30
	Zhejiang Dingli	603338 CH	BUY	94.00
Consumer Discretionary	Jiumaojiu	9922 HK	BUY	11.44
	Haidilao	6862 HK	BUY	37.90
	Anta	2020 HK	BUY	77.39
	Li Ning	2331 HK	BUY	29.73
	Xtep	1368 HK	BUY	2.90
	Midea	000333 CH	BUY	72.80
	JS Global	1691 HK	BUY	9.97
Consumer Staples	CR Beer	291 HK	NR	N/A
	Tsingtao Brewery	168 HK	NR	N/A
Education	Hope Education	1765 HK	BUY	2.80
	China Education	839 HK	NR	N/A
	Yuhua Education	6169 HK	NR	N/A
	Minsheng Education	1569 HK	NR	N/A
	Kepei	1890 HK	NR	N/A
Auto	GAC Group	2238 HK	BUY	10.91
	Geely Auto	175 HK	BUY	13.10
Internet	Alibaba	BABA US	BUY	229.80
	Meituan-Dianping	3690 HK	BUY	120.00
	Pinduoduo	PDD US	BUY	40.50
	Tongcheng-Elong	780 HK	BUY	15.00

Source: CMBIS

China Capital Goods Sector

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It's almost certain that infrastructure spending will continue to be the key measure to support the economy. We expect the approval of more projects following the NPC & CPPCC meetings. Besides, we expect more supportive policies to the elimination of National Emission Standard (NES) III trucks going forward. All these will offer upside to the demand for construction machinery and heavy-duty truck (HDT) in 2H20E, in our view.

We expect more positive news flow during the meetings, which will continue to boost market sentiment. We are staying positive on **SANY Heavy (600031 CH), Jiangsu Hengli (601100 CH), Zoomlion (1157 HK, 000157 CH), Sinotruk (3808 HK), Weichai Power (2338 HK, 000338 CH)** and **Zhejiang Dingli (603338 CH)**.

China Consumer Discretionary Sector

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We expect more favorable policies to support employment and stabilize the economy. Since consumer sector contributed to 57.8% of GDP growth in 2019, it should continue to be critical in 2020. Over RMB 19 bn of consumer coupons have been issued in over 170 cities in China since Mar 2020, but we do expect more to be issued, even with longer period, greater size, wider target group and better design or more directly towards the vulnerable groups and to aid more small and micro businesses.

We expect stimuli to skewed towards the more affected sectors, therefore more positive to: 1) home appliances (esp. large and white goods), 2) catering, 3) apparel and sportswear, 4) domestic tourism. We are positive on **Jiumaojiu (9922 HK), Haidilao (6862 HK), Anta (2020 HK), Li Ning (2331 HK), Xtep (1368 HK), Midea (000333 CH)** and **JS Global (1691 HK).**

China Consumer Staples Sector

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We expect the government could provide policies to support catering sector, which is vastly affected by COVID-19. Because catering sector is a major sales channel of beer sector, we see **CR Beer (291 HK)** and **Tsingtao Brewery (168 HK)** could benefit from potential policies. Near 40% of sales volume of CR Beer comes from catering sector and we estimate such ratio would be higher for Tsingtao Beer.

China Education Sector

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This year, number of Gaokao applicants increases by 0.4mn to 10.71mn and number of higher education graduates increases by 0.4mn to 8.74mn. Ministry of Education will increase the admission quota of master degree and diploma-to-degree by 0.19mn and 0.32mn, respectively. Also, it is studying to launch the admission of second-degree program. We expect the government to mention policies to stabilize employment, including expand the admission quota of higher education.

We reiterate our Overweight rating on higher education sector. Our top pick is **Hope Education (1765 HK)**. We also recommend **China Education (839 HK), Yuhua Education (6169 HK), Minsheng Education (1569 HK)** and **Kepei (1890 HK)** (whose diploma-to-degree admission quota surged 11 times this year).

China Auto Sector

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Since the outbreak of COVID-19, the Chinese government has repeatedly stressed the role of consumption for fostering economic recovery. In 2019, the auto industry accounts for 9.6% of the total retail sales putting itself under the spotlight among consumption recovery. In addition, the total employment of auto and related industries accounts for about 10% of total employment, which also plays a key role in stabilizing employment. Since Feb 2020, great amounts of provinces/cities have rolled out auto support policies such as direct subsidies ranging from RMB3K to 10K. We observe a promising result as PV sales volume achieved an increase of 36.6% MoM.

We expect the government may introduce nation-wide purchase tax reductions, boosting auto consumption in the countryside, and other national-level policies to further support the auto market during the two sessions. We believe that a wide range of subsidy policies will help local brands to expand the market share. Therefore, we continue to recommend stocks that have strong local brand recognition and high price elasticity. Our top picks remain as **GAC Group (2238 HK)** and **Geely Auto (175 HK)**.

China Internet Sector

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China Internet sector has been more resilient amidst COVID-19, and can benefit long-term from offline consumption's shift to online, coupled with higher MAU & time spent. With the stabilization of domestic market and work resumption, we observed a series of consumption stimulating policies roll out (e.g. consumption coupons, shopping festival) to boost economy recovery. We expect the government to emphasize on "Consumption internet <消费互联网>" and "Industrial internet <工业互联网>", from the following aspects: 1) consumption-driven policies to promote ecommerce and OTA recovery (e.g. subsidies, tax benefit, tourism discount); 2) to encourage ecommerce / lifestyle / entertainment players to carry out large-scale promotions (e.g. live streaming ecommerce <直播带货>, team purchase) with offline business; 3) to leverage big data, AI and "internet +" on epidemic analysis and economy recovery (e.g. new infrastructure strategy); and 4) structural change opportunities, such as rising adaption of cloud business, online education, food delivery, etc.

We expect ecommerce / lifestyle / OTA players to be the key beneficiary from the two sessions, and our top picks are **Alibaba (BABA US), Meituan-Dianping (3690 HK)**. We also suggest investors to look at **Pinduoduo (PDD US)** and **Tongcheng-Elong (780 HK)**, for domestic OTA recovery, temporary & partial consumption downgrade.

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