Strategy – 2H Outlook

Growth stocks to regain momentum

We analysed some of the key factors in 2H 2021, including the Fed's roadmap of tapering, China's inflations, and sector rotation. We maintain our view that growth stocks would regain momentum and outperform value stocks in 2H 2021. Suggest to accumulate Internet, Software & IT Services, Technology, Healthcare stocks in HK market.

- **Fed's taper roadmap.** We expect the Fed to issue forward guidance on reducing bond purchases as early as in Sep 2021, begin tapering next year and end QE by the end of next year. Our forecasted roadmap is quite similar to the previous tightening cycle during 2014-2019.
- **Market impact before and during tapering.** We reviewed various asset classes' performance before and during the last tapering period as a reference. Pre-tapering, stocks kept rising, with growth stocks outperforming value and small caps outperforming large caps, USD stayed weak while EM currencies started weakening, and commodities directionless.
- **China's inflation outlook.** While the Fed is contemplating policy normalisation to keep inflations in check, the CPI inflation pressure in China is much more subdued. China's inflation pressure is more reflected on PPI which reached 9.0% YoY in May. We expect PPI growth would slow down in 2H as low-base effect subsides, to around 3.8% YoY by year end.
- **China's narrowing PPI-CPI gap bodes well for growth stocks.** We expect the PPI-CPI growth gap will narrow in 2H 2021, similar to in 2017, when growth stocks significantly outperformed value stocks, as upstream earnings growth slowed while downstream margin pressure eased.
- **Factors supporting our positive outlook on growth stocks include:**
  1. Economic growth and earnings would start to normalise in 2H 2021 as the low-base effect dissipates, and thus interest in growth sectors will re-emerge due to their superior growth prospect;
  2. Growth stocks tend to outperform value stocks as long as the Fed maintains QE pace, and we expect the Fed to start tapering only in 2022;
  3. Chinese value stocks tend to underperform when PPI peaks out, which is likely in 2H 2021;
  4. Ratio analysis shows that US growth stocks have just regained momentum versus value stocks.
- **Accumulate Internet, Software & IT Services, Technology, Healthcare sectors.** Avoid or take profit on upstream Energy and Materials stocks.

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

Market Data

Hang Seng Index	29,152
52-week High / Low	31,183/23,124
3-month avg. daily t/o	HK$151.4bn

Source: Bloomberg

Indices Performance

	HSI	HSCEI	HSTECH
1-month	-2.1%	-2.2%	2.4%
3-month	-3.6%	-7.1%	-3.3%
6-month	-2.5%	-7.9%	-6.7%

Source: Bloomberg

12-month HSI Performance

Source: Bloomberg

Related Reports

1. Strategy Report – Short-term Value; Medium-term Growth – 1 Jun 2021
2. Strategy Report – Buy in May; HSI target raised – 3 May 2021
3. Strategy Report – Style shift to take a break – 1 Apr 2021
4. Strategy Report – Don't panic over rising bond yield – 3 Mar 2021
5. Strategy Report – HSI enhancement preview – 24 Feb 2021
6. Strategy Report – Follow the tide – 3 Feb 2021
7. Strategy Report – Southbound inflows lift H-shares – 21 Jan 2021
8. Strategy Report – Keep faith in value stocks – 5 Jan 2021
9. 2021 Strategy Report –HSI targets 30,000 on post-pandemic recovery – 10 Dec 2020
10. Strategy Report – Start of the end of the pandemic? – 10 Nov 2020

Please cast your valuable vote for CMBIS research team in the 2021 Asiamoney Brokers Poll:

https://euromoney.com/brokers

Contents

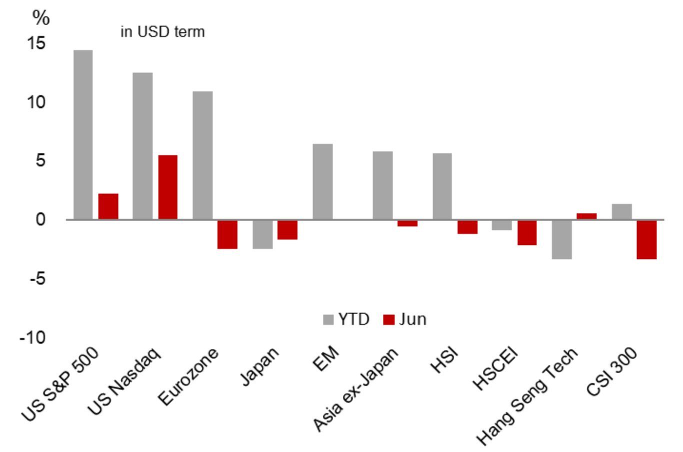
Recap of 1H 2021

Stocks gained on economic recovery

Throughout 1H 2021, markets have been driven by the ongoing global economic recovery, thanks to vaccination against COVID-19, easing of lockdown measures, plus monetary and fiscal stimuli.

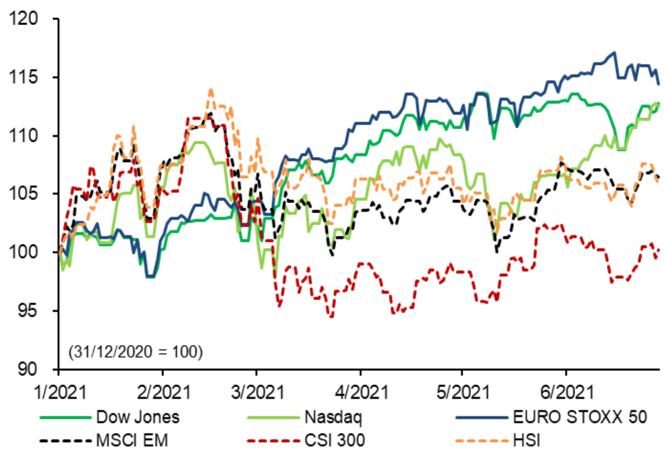
Major stock markets recorded gains, with the US and Europe outperforming EM (Fig. 1 & 2), partly due to the better vaccination progress in Western countries.

Figure 1: Major stock markets' performance YTD



Source: Bloomberg, CMBIS

Figure 2: US & Europe outperformed EM

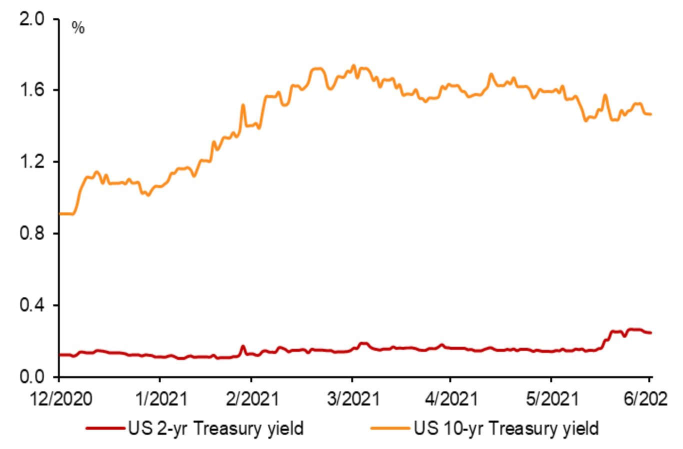


Source: Bloomberg, CMBIS

Bond yields rose as inflations spiked

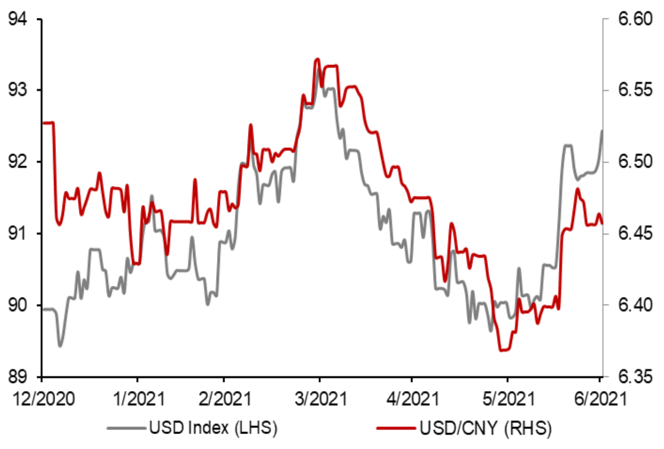
Bond yields have been trending up, as inflation pressures are piling up due to demand recovery and supply shortage. The rapid surge in bond yield in Jan-Feb caused some sell-offs in stock markets, especially high-valuation growth stocks. Towards the end of 1H, shorter-term yields rose as the US Federal Reserve signalled possible rate hikes in 2023 (Fig. 3).

Figure 3: US Treasury yields trending up



Source: Bloomberg, CMBIS

Figure 4: USD rebounded from multi-year low



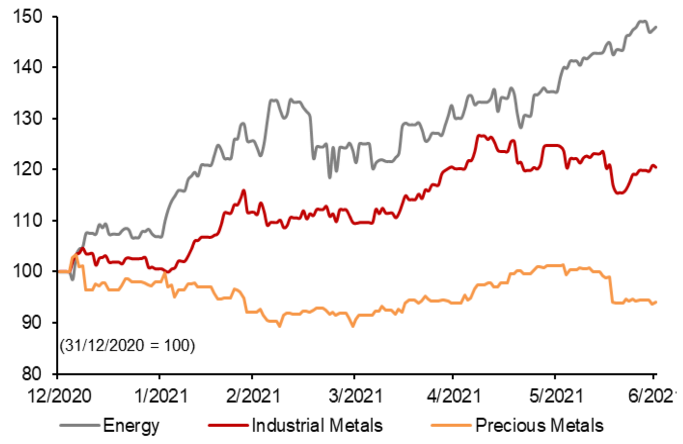
Source: Bloomberg, CMBIS

The USD rebounded somewhat from multi-year low in early 2021, as expectations of the Fed to start exiting monetary stimuli built up. The CNY appreciated mildly, extending its strong run since mid-2020 (Fig. 4), as China's monetary policy was relatively stable (less accommodative than the West).

■ Oil, base metals & shipping freights surged

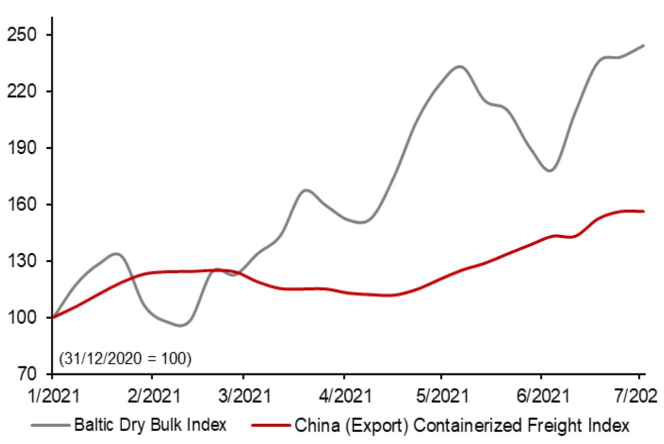
Commodities have generally been riding on the recovery in demand and supply shortage (which may be transitory, as the Fed put it). Energy and base metal prices surged. But precious metals dropped as their safe haven role diminished in a risk-on market (Fig. 5). Shipping freights, in similar fashion to commodities, enjoyed a strong run (Fig. 6).

Figure 5: Global stock markets' return in May 2021



Source: Bloomberg, S&P GSCI, CMBIS

Figure 6: Shipping freights skyrocketed

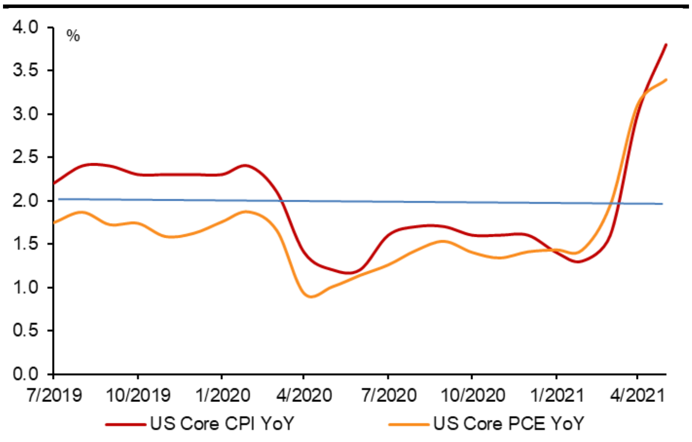


Source: Bloomberg, CMBIS

■ Inflations rising

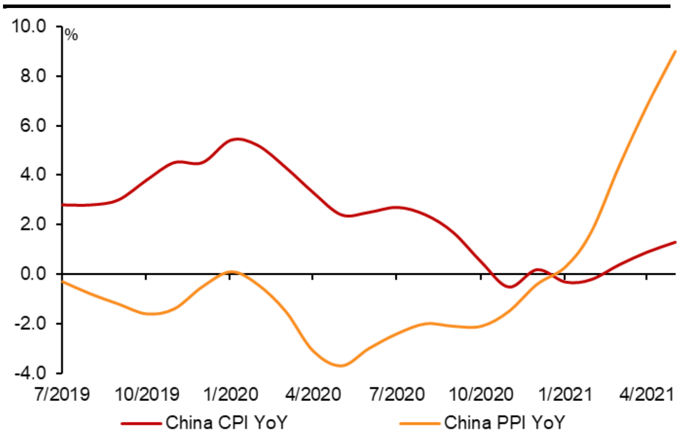
Inflation in the US has exceeded 2% since Apr 2021, but the Fed, by introducing "average inflation targeting", would allow inflation to remain elevated for some time before taking actions (Fig. 7). In China, PPI has been rising quickly, driven by upstream prices, which have not yet fully passed on to CPI (Fig. 8).

Figure 7: US core inflations exceed 2%



Source: Bloomberg, CMBIS

Figure 8: China: high PPI and mild CPI



Source: Bloomberg, CMBIS

Fed's Taper: roadmap and market impact

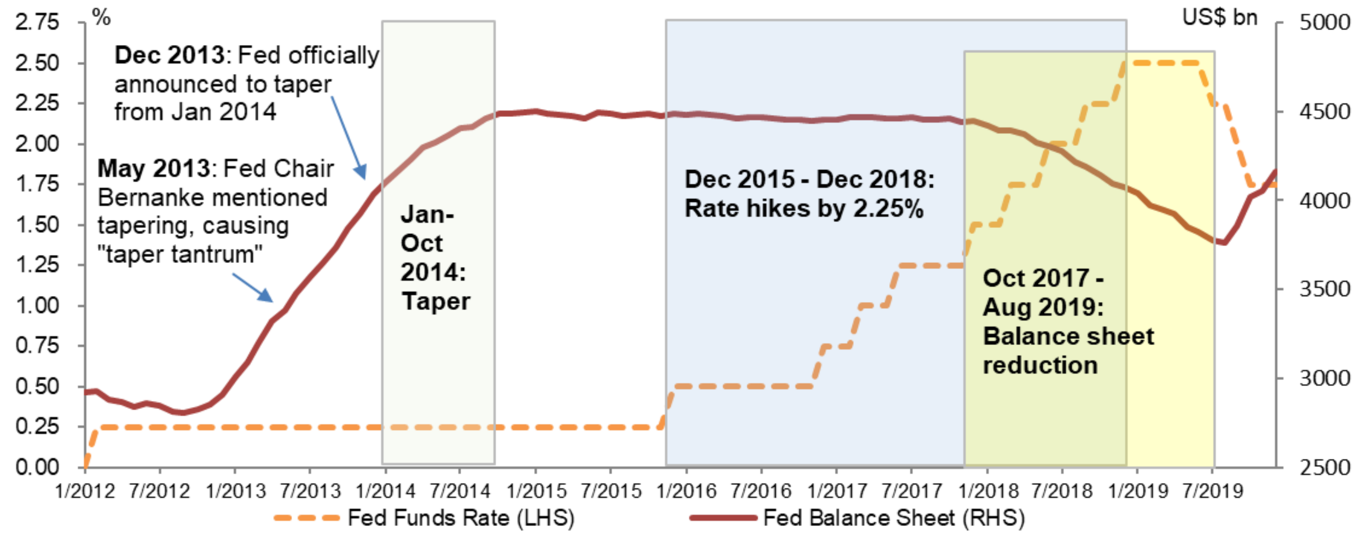
Forward guidance on tapering as early as in Sep 2021

Our Chief Economist, Edward Ding, expects "the Fed to issue forward guidance on reducing bond purchases as early as in Sep 2021, begin tapering next year and end quantitative easing by the end of next year." The Fed's dot plot "implies 2-3 interest rate increases in 2023".

Let's take a look at the steps in the Fed's last tightening cycle during 2014-2019 (Fig. 9):

1. Fed Chairman Ben Bernanke first discussed tapering of QE in May-Jun 2013;
2. Fed officially announced its decision to start tapering in Jan 2014;
3. Started tapering in Jan 2014, and ended QE in Oct 2014;
4. Entered rate hike cycle, raising 2.25 percentage points during Dec 2015-Dec 2018;
5. In the middle of the rate hike cycle, started balance sheet normalisation (reduction).

Figure 9: Federal Reserve's tightening cycle in 2014-2018



Source: Federal Reserve, Bloomberg, CMBIS

Our forecasted roadmap is quite similar to the previous tightening cycle, i.e. the Fed started giving forward guidance of tapering several months before taking actions, and then spent almost a year on tapering, and then waited for about a year before starting a rate hike cycle.

Market impact before and during tapering

Given that Fed funds rate hikes are expected to be more than a year away, investors' current concerns should be on tapering and, more immediately, pre-tapering.

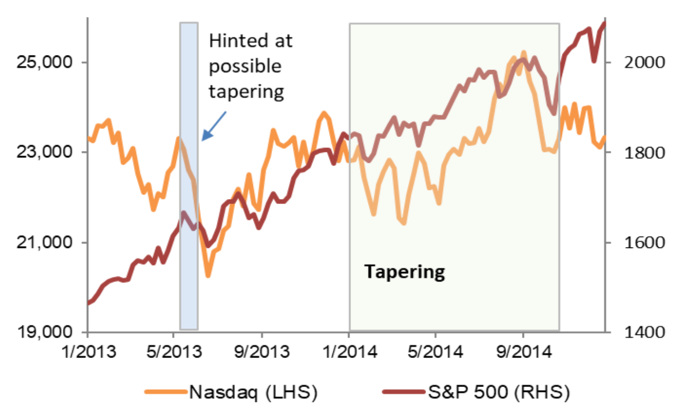
How did major asset classes perform during and before the tapering in 2014?

■ **Stock markets kept rising with more volatility**

After a brief sell-off in May 2013 (now known as "taper tantrum") triggered by Bernanke's speech, stock markets swiftly resumed uptrend before the Fed formally announced tapering in Dec 2013. During Jan-Oct 2014 when tapering actually took place, S&P 500 kept rising, while Nasdaq also rose but was more bumpy (Fig. 10).

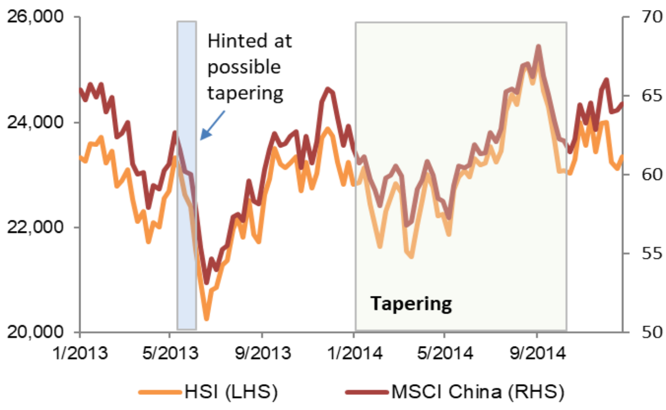
China/HK stock markets shown a similar pattern to the US market in the pre-tapering period (May-Dec 2013), and then went up mildly with some fluctuations during tapering (Fig. 11).

Figure 10: US stocks continued to rise during taper



Source: Bloomberg, CMBIS

Figure 11: China/HK stocks fluctuated during taper



Source: Bloomberg, CMBIS

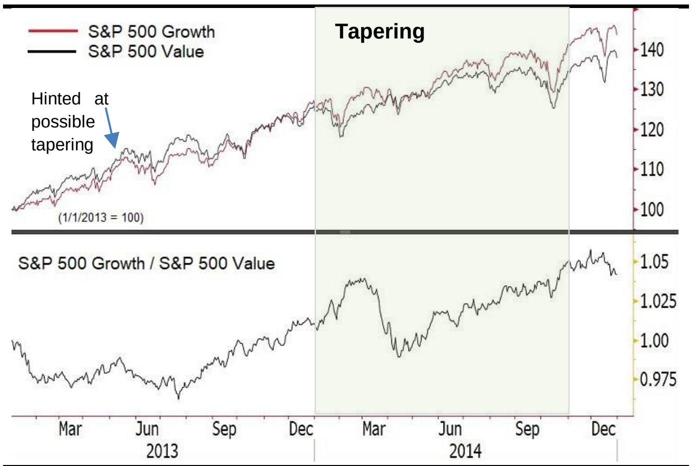
■ **Growth vs Value stocks**

If we look at the relative performance of growth stocks versus value stocks, **tapering seemed to shift the momentum from growth to value**.

In US market, growth outperformed value pre-tapering, presumably because the Fed was still printing money at full speed and thus lent support to high-valuation growth stocks. During tapering, when the Fed was still printing money but at a slower pace, growth stocks still outperformed value over the whole period, but had more corrections (Fig. 12).

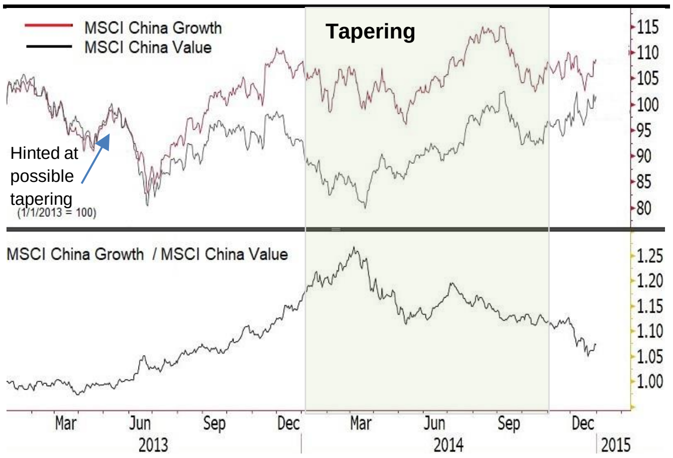
In China, the style shift from growth to value was more obvious, i.e. growth outperformed during pre-tapering, but value outperformed during tapering (Fig. 13). It seemed growth stocks' valuation was more sensitive to the dwindling liquidity injection.

Figure 12: US Growth stocks outperformed



Source: Bloomberg, CMBIS

Figure 13: China Value stocks outperformed

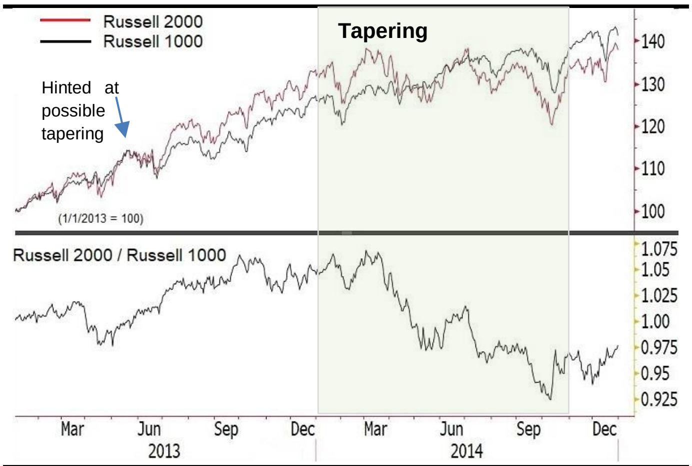


Source: Bloomberg, CMBIS

■ **Large caps vs Small-Mid caps**

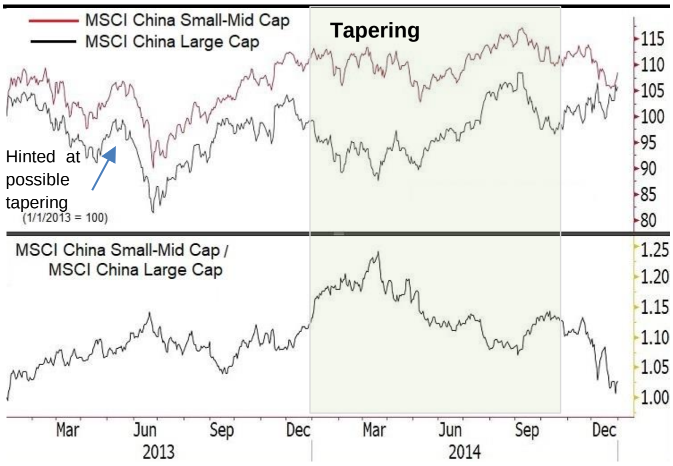
There was also a style shift from small caps to large caps. Small caps outperformed large caps in both US and China markets pre-tapering during May-Dec in 2013, but then **large caps outperformed quite significantly during tapering** (Fig. 14 & 15), presumably because small caps are typically more sensitive to changes in liquidity.

Figure 14: US small caps underperformed



Source: Bloomberg, CMBIS

Figure 15: China small caps underperformed



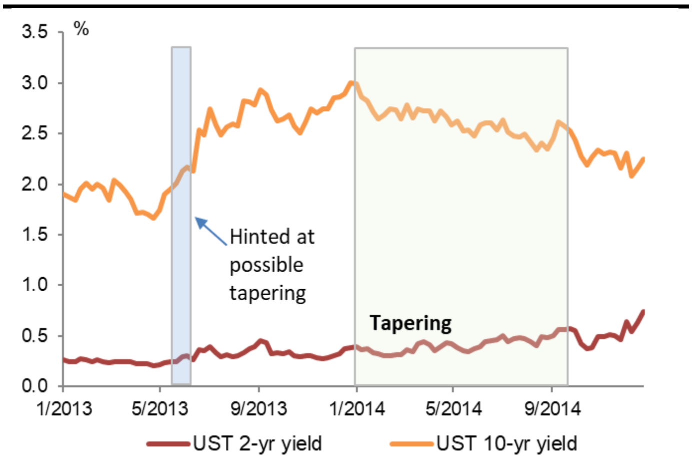
Source: Bloomberg, CMBIS

■ **Bonds & Currencies**

The US Treasury yield curve flattened during tapering in 2014. 2-year yield rose, in anticipation of Fed funds rate hike in near future, while 10-year yield went down since long-term economic growth and inflation expectations moderated as monetary easings were set to withdraw (Fig 16).

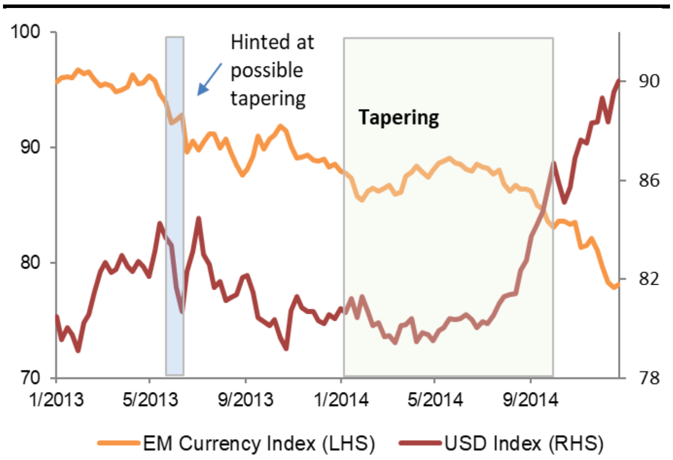
In currency market, **USD stayed weak pre-tapering, before strengthening during tapering**. In contrast, emerging markets currencies were weakening both pre- and during tapering (Fig. 17).

Figure 16: US 10-yr & 2-yr yield spread narrowed



Source: Bloomberg, CMBIS

Figure 17: USD up & EM currency down during taper

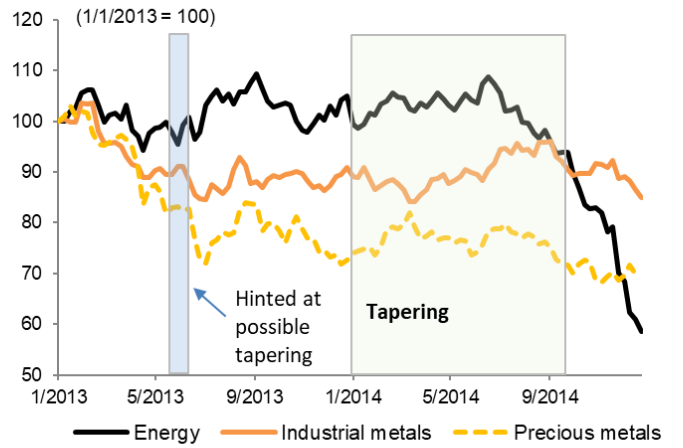


Source: Bloomberg, CMBIS

Commodities

Commodity prices, whether they were energy, industrial metals or precious metals, were relatively directionless before and during tapering (Fig. 18).

Figure 18: Commodities directionless during taper



Source: Bloomberg, CMBIS

Summary of various asset classes' performance

To sum up, the performance of various asset classes pre- and during tapering in 2013-2014 were as follows.

In the 6-month period before tapering (2H 2013):

- Stocks kept rising
- Growth stocks outperformed value stocks
- Small caps outperformed large caps
- USD stayed weak, EM currencies started weakening
- Commodities directionless

During tapering (Jan-Oct 2014):

- Stocks rose more mildly and become more bumpy
- US growth stocks outperformed value but had more corrections; China value stocks outperformed growth stocks
- Large caps outperformed small caps
- USD strengthened, EM currencies weakened further
- Commodities directionless

China's inflation outlook and impact on sectors

PPI and CPI gap to narrow

While the Fed is contemplating policy normalisation in the wake of rising consumer prices, the CPI inflation pressure in China is much more subdued. Our Chief Economist, Edward Ding, expects China's CPI inflation in 2021 to average at around 1.2%, far below the policy target of 3%. China's inflation pressure is more reflected on PPI, reached 9.0% YoY in May. We expect PPI growth would slow down in 2H as low-base effect subsides, to around 3.8% YoY by year end.

- **PBOC to maintain stable policy**

As for China's monetary policy outlook, our Chief Economist believes that "the People's Bank of China (PBOC) has no intention of disturbing the market, as growth and inflation are within its desired range. If the economy shows signs of weakening, PBOC may consider loosening."

Impact on corporate earnings, stock market and sectors

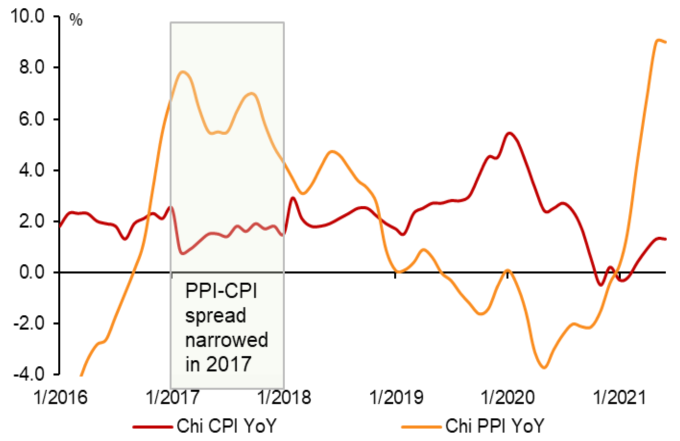
- **Corporate earnings: upstream and downstream become more balanced**

Our Chief Economist points out that "since the beginning of this year, the rapid rise of PPI has led to the rapid expansion of the PPI-CPI growth gap. As a result, the profits of the upstream industries squeezed that of the downstream ones. In the second half of this year, however, the PPI-CPI growth gap will gradually narrow."

- **Which sectors would outperform when PPI-CPI spread narrows?**

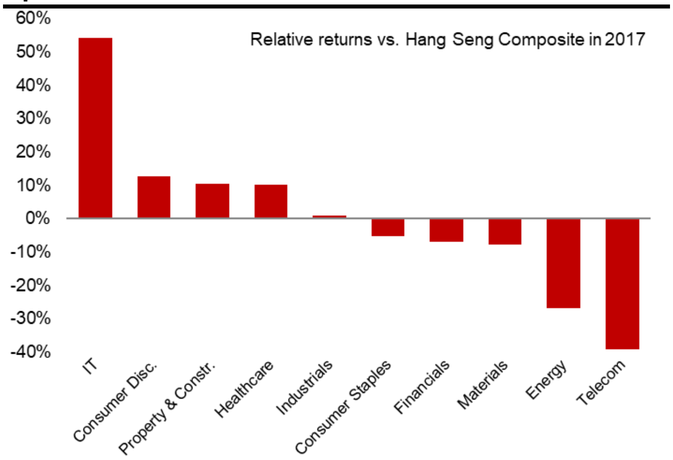
The current wide spread between PPI and CPI growth and the expected narrowing of the spread in coming months are reminiscent of the trend in 2017, when PPI growth peaked at 7.8% in Feb 2017, while CPI growth started rebounding gradually (Fig. 19).

Figure 19: PPI and CPI spread may narrow as in 2017



Source: Bloomberg, CMBIS

Figure 20: Sectors' relative returns when PPI-CPI spread narrowed in 2017



Source: Bloomberg, CMBIS

During that period **when PPI-CPI growth gap narrowed, sectors showed divergent performance in HK stock market, and growth stocks significantly outperformed value stocks.** We compared major sectors' returns relative to the Hang Seng Composite Index (HSCI) (Fig. 20), and found that growth stocks (IT, Healthcare, Consumer) in general outperformed value (Financials, Materials, Energy, Telecom).

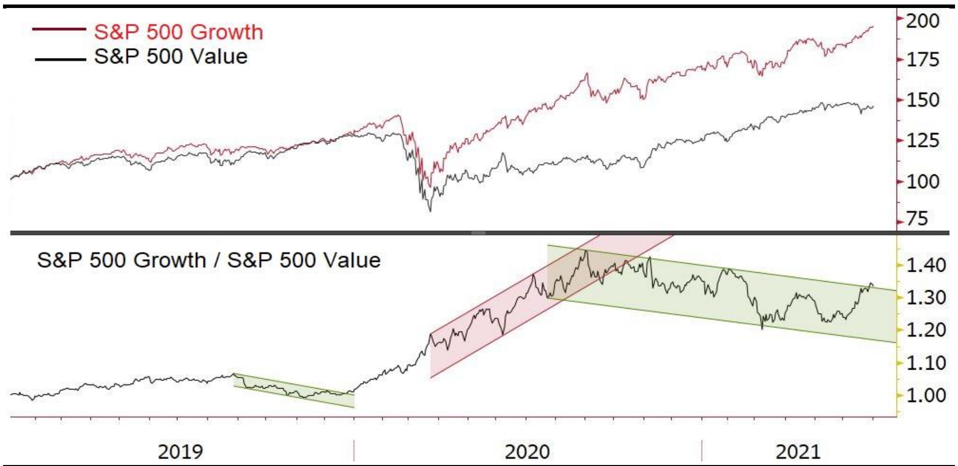
We attribute growth stocks' outperformance to two reasons: 1) that year (2017) was a strong one for HK stocks, with the HSCI gaining 38%. That is, market was on a risk-on mode, where growth stocks typically enjoy more gains than value; 2) **as China PPI growth moderated, upstream earnings growth slowed**, causing the underperformance in Materials and Energy, and on the other hand, **downstream margin pressure eased** which was positive for Consumer, Healthcare, etc.

Technical Analysis: Growth regaining momentum vs. Value

COVID-19 has intensified sector rotation and divergence. Since its outbreak in Q1 2020, growth stocks, led by internet, has remarkably outperformed value stocks for more than half a year. Then, around Sep-Oct 2020, when investors started betting on vaccination, lockdown easing and economic recovery, value stocks started outperforming (until Mar 2021 in the US and May 2021 in China).

Based on ratio analysis, **US growth stocks apparently have regained momentum versus value stocks**, with the ratio of S&P 500 Growth / Value recently breaking the top of a downward channel (Fig. 21).

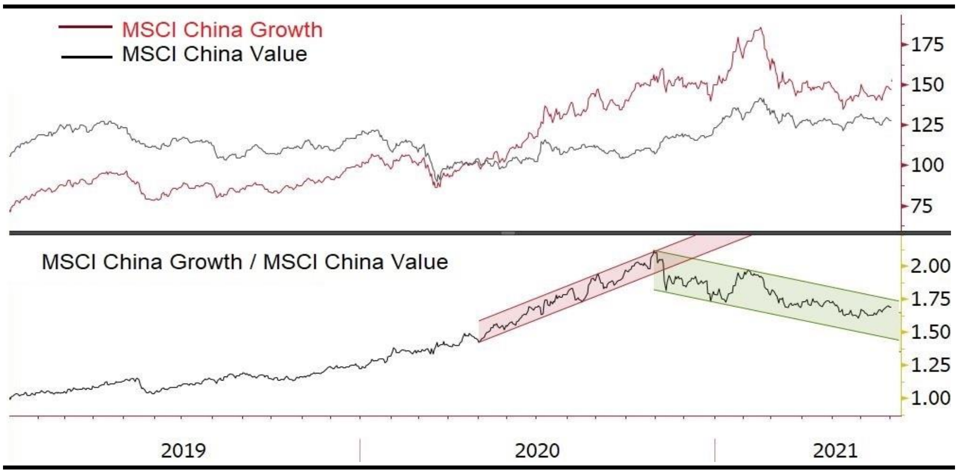
Figure 21: US growth stocks turning strong vs. value stocks



Source: Bloomberg, CMBIS

In China, where anti-trust and related policy risks are dragging on internet giants, **growth stocks are not as strong as their US counterparts, but have at least stabilised in terms of relative performance versus value stocks** (Fig. 22). Watch out for an upward breakout of the downward channel in the ratio of MSCI China Growth / Value as a confirmation of growth stocks regaining momentum.

Figure 22: Chinese growth stocks are stabilising vs. value stocks



Source: Bloomberg, CMBIS

Strategy: Accumulate Growth stocks

We maintain our view from our previous Monthly Strategy Report (link) that **growth stocks would regain momentum and outperform value stocks in 2H 2021**. **Accumulate Internet, Software & IT Services, Technology, Healthcare sectors.** Avoid or take profit on upstream Energy and Materials stocks.

Factors supporting our positive outlook on growth stocks include:

1) **Economic growth and earnings would start to normalise in 2H 2021** as the low-base effect dissipates. Investor interest on growth sectors will probably re-emerge due to their superior growth prospect.
2) **Growth stocks tend to outperform value stocks as long as the Fed maintains QE pace**, if the history during the pre-tapering period in 2H 2013 is any guide. We expect the Fed to start tapering only in 2022.
3) **Chinese value stocks tend to underperform when PPI peaks out**, as upstream (value sectors) margins retreat and downstream (growth sectors) margin pressure eases. We expect PPI YoY growth to retreat from the peak 9.0% to around 3.8% by year end.
4) **Ratio analysis shows that US growth stocks have just regained momentum versus value stocks.** Chinese growth stocks might follow suit some time later.

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.