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Strategy Report

Sell before May

With the HSI confirming a bearish technical pattern, a series of share placements over the past two weeks, and potentially weak economic data & corporate earnings/guidance, we reiterate that the HSI may fall again to form a "second leg" before really bottoming out. Tactically sell into this rally. Wait for better entry point (HSI at 22,000-23,000) to accumulate growth stocks and recovery plays.

- **Bearish pattern "Rising Wedge".** Since bottoming at 21,139, the HSI has formed a bearish pattern "Rising Wedge". The support line was broken yesterday, confirming the bearish pattern. Expect to fall to at least 22,800. A similar pattern has formed in the S&P 500 too.

- **Major shareholders are selling.** Over the past two weeks when the HSI was hovering at 24,000, major shareholders of Sino Biopharm (1177 HK) (HSI constituent), China Gas (384 HK) (HSCEI constituent), among others, reduced stakes. The last time there were a series of share placements was in Jan 2020 when the HSI was peaking. Not a good omen.

- **Sectors outperforming the most may face profit-taking pressure.** Internet, healthcare, property management are among the most resilient sectors during these volatile months, enjoying the biggest rebounds and returned to peaks. While they are less affected by the COVID-19 pandemic and have higher earnings visibility, the fact that they have outperformed so much might lead to profit-taking when the broad market retreats.

- **Sell before May, despite cheap valuations.** While the HSI is still cheap (2020E P/E at 10.3x; P/B at 1.01x) and thus attractive for long-term investors, there could be further downside in earnings forecast as we enter Q1 earnings season. With the COVID-19 still posing huge uncertainties to global economy and corporate earnings, and the slump in oil prices adding risks of bankruptcies and defaults, the "Sell in May" seasonal weakness may well happen this year.

- **OW Capital Goods; Accumulate Internet/Healthcare/Auto/Consumer**. For now, we prefer Capital Goods sector as infrastructure policy play. Wait for better entry point to accumulate growth stocks like Internet and Healthcare, and recovery plays such as Auto and Consumer Discretionary.

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

Market Data

Hang Seng Index	23,794
52-week High / Low	30,112/21,139
3-month avg. daily t/o	HK$121.3bn

Source: Bloomberg

Indices Performance

	HSI	HSCEI
1-month	4.3%	5.4%
3-month	-16.0%	-14.0%
6-month	-11.2%	-8.7%

Source: Bloomberg

12-month HSI Performance

Source: Bloomberg

Related Reports

1. Strategy Report – Gauging China's recovery and impact on HK stock market – 6 Apr 2020
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First round of rebound may be over

Technical analysis: HSI formed bearish "Rising Wedge"

Since bottoming out at 21,139 on 19 Mar, the HSI has reached 38.2% Fibonacci retracement level 24,207 and faced strong resistance over the past two weeks (Fig. 1).

At the same time, the HSI has formed a bearish pattern "Rising Wedge", with volume decreasing which is a typical feature of this pattern. The support line was broken yesterday on increased volume, confirming the bearish pattern (Fig. 2). Expect to fall to at least 22,800.

Figure 1: HSI reached 38.2% Fibonacci retracement

Source: Bloomberg, CMBIS

Figure 2: HSI broke support of Rising Wedge

Source: Bloomberg, CMBIS

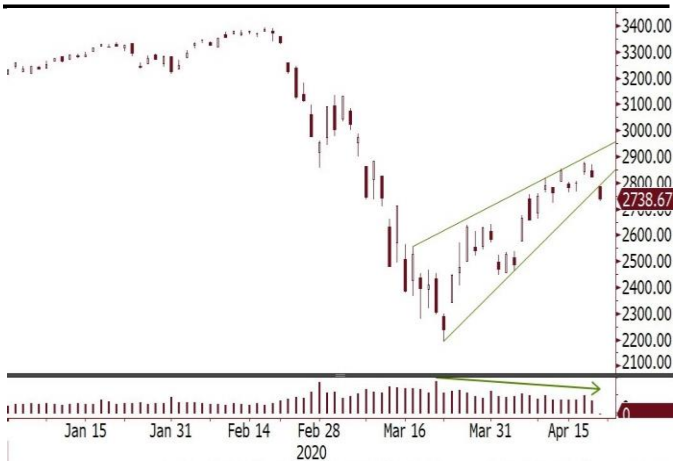
The U.S. market's rebound has been even stronger, with the S&P 500 reaching 50% Fibonacci retracement level since bottoming out on 23 Mar (Fig. 3).

Similar to the HSI, the S&P 500 has formed a bearish pattern "Rising Wedge", and the support line has just been broken (Fig. 4).

Figure 3: SPX reached 50% Fibonacci retracement

Source: Bloomberg, CMBIS

Figure 4: SPX broke support of Rising Wedge



Source: Bloomberg, CMBIS

Major shareholders are selling

Over the past two weeks when the HSI was hovering at 24,000, major shareholders of Sino Biopharm (1177 HK) (HSI constituent), China Gas (384 HK) (HSCEI constituent), Longfor Group (960 HK) and Meidong Auto (1268 HK) reduced stakes. The first three stocks are big caps with market cap >HK$100bn.

The last time there were a series of share placements was in Jan 2020 when the HSI was peaking. Not a good omen.

Sectors outperforming the most may face profit-taking pressure

We compared major sectors' performance since the HSI peaked on 20 Jan, and how much they rebounded from their troughs.

Internet, healthcare, property management are among the most resilient sectors during these volatile months, enjoying the biggest rebounds and returned to peaks. While they are less affected by the COVID-19 pandemic and have higher earnings visibility, the fact that they have outperformed so much might lead to profit-taking when the broad market retreats.

Figure 5: Sector performance since market peaked and troughed

Sector	From trough (%)	From 20 Jan close (%)
China property mgmt/services	43.8	26.0
Healthcare	32.6	-1.0
Consumer discretionary	32.2	-19.5
Telecom carriers	28.8	-23.2
Internet	28.5	0.3
Capital goods	25.2	-2.4
China property	23.7	-14.3
HK property developers	23.5	-16.6
Renewable energy	21.9	-16.3
HK Utilities	21.7	-8.5
China Insurance	20.1	-24.3
Tech hardware	19.9	-28.8
Non-bank financials	19.1	-18.4
Education	18.4	-16.9
Auto	17.4	-16.9
Consumer staples (F&B)	15.8	-15.4
REITs	14.1	-23.1
Hang Seng Index	**12.6**	**-17.4**
Transportation	11.1	-19.3
HK/Int'l banks	7.0	-30.0
China banks	6.1	-11.5

Source: Bloomberg, CMBIS, as of 21 Apr
For sectors covered by CMBIS, performances are simple average of stocks under our coverage

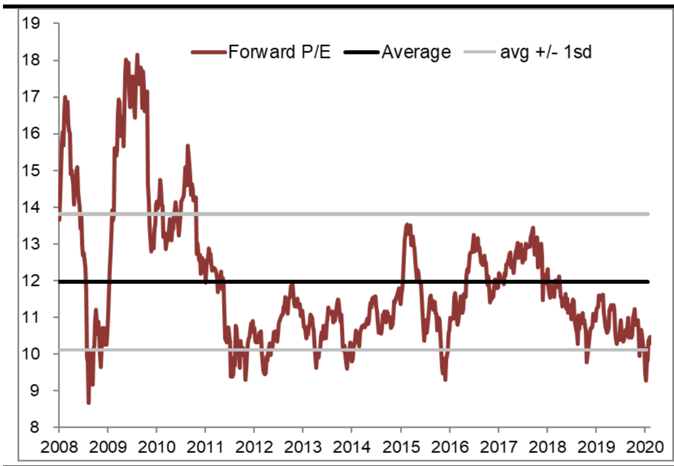
Sell before May, despite cheap valuations

We maintain that the HSI is still cheap (2020E P/E at 10.3x; P/B at 1.01x) and thus attractive for long-term investors. That said, due to the impact and uncertainties brought about by the pandemic and slump in oil prices, there could be further downside in earnings forecast as we enter Q1 earnings season, and U.S. and Chinese companies may give prudent guidance.

We pointed out in our Strategy Report on 6 Apr that, after massive sell-offs and a subsequent rebound, both the U.S. and HK stock markets usually formed a "second leg", and that we "expect the HSI to rebound to 24,200 in the short term, and then fall again to form a second leg to bottom out." We reiterate this view.

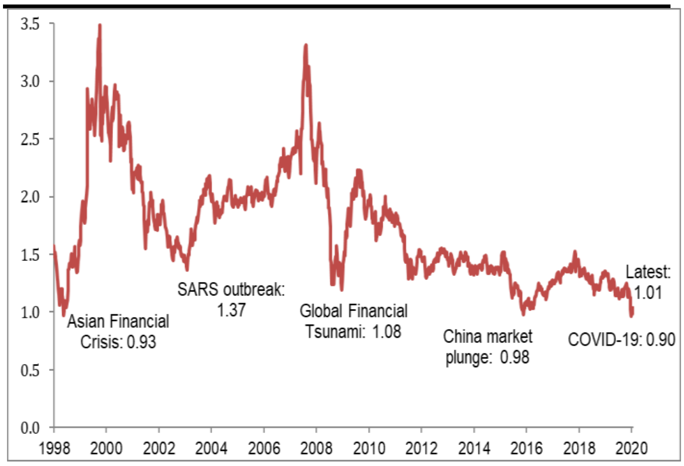
Suggest tactically sell into this rally, and wait for better entry points (HSI at 22,000-23,000) in the next 1-2 months. With the COVID-19 still posing huge uncertainties to global economy and corporate earnings, and the spectacular slump in oil prices adding risks of bankruptcies and defaults, the "Sell in May" seasonal weakness may well happen this year.

Figure 6: HSI 2020E P/E at 10.3x



Source: Bloomberg, CMBIS

Figure 7: HSI P/B at 1.01x



Source: Bloomberg, CMBIS

OW Capital Goods; Accumulate Internet/Healthcare/Auto/Consumer

For now, we prefer Capital Goods sector as infrastructure policy play (see sector report on 13 Apr).

Wait for better entry point to accumulate growth stocks like Internet and Healthcare, and recovery plays such as Auto and Consumer Discretionary.

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CMB International Securities Limited

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

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