

China / HK Market Weekly

Sector rotation into value stocks

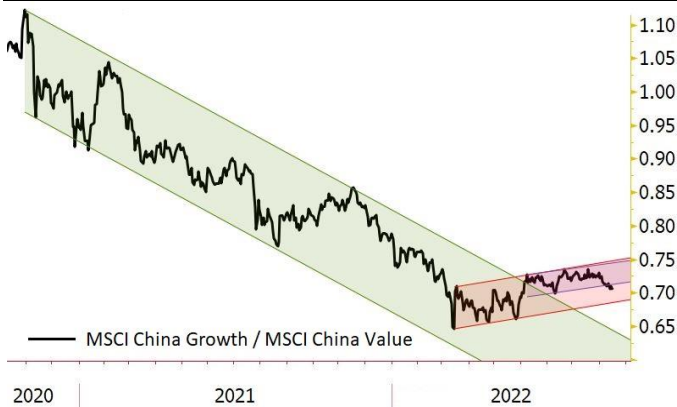
Last week (12-16 Sep), major stock markets around the world declined by over 2% as higher-than-expected CPI inflation in the US stoked rate hike and recession concerns. This week, all eyes will be on the FOMC meeting as investors are betting on at least a 75-bps rate hike. Investors will probably stay prudent before the FOMC decision, while cheap valuations in the HSI should offer some downside protection. We are turning relatively bullish on value stocks over growth stocks, as further credit loosening in China bodes well for cyclical sectors.

- **Market recap:** The HSI / CSI 300 / S&P 500 were -3.1% / -3.9% / -4.8% last week (Fig. 3). A hotter-than-expected inflation report in the US on Tuesday sparked a selloff in stocks. Better-than-feared China's economic growth data in Aug did not offer much help in sentiments, while further depreciation in the RMB continued to weigh on China / HK stocks. By sector, only Consumer Staples & Telecom gained in HK (Fig. 5).
- **Interest rates:** US interest rate hike expectations continued to heighten after the hot CPI inflation data. Interest rate futures implied Fed funds rate would reach 4.19% in Dec 2022, 31 bps higher than the implied rate a week ago (Fig. 10 & 11).
- **Sentiment:** Short-sell ratio on HK mainboard stayed around 18.5% last week, after coming down from a record-high in late-Aug (Fig. 19). The short-squeeze rebound on 9 & 13 Sep may well be over. By sector, short-sell ratios increased in Property, Materials, Consumer Discretionary & Consumer Staples, and decreased in IT, Healthcare, Utilities & Industrials.
- **Earnings:** Consensus EPS of the HSI / HSTECH / CSI 300 were revised by -0.9% / -2.0% / 0% last week (Fig. 36-38), partly due to the 0.9% depreciation in the RMB against the USD. Property, Financials & Industrials were the main drag on the HSI EPS forecast.
- **Market outlook:** Before the FOMC decision on Wednesday night, we expect sentiments in China / HK markets would remain prudent. The Fed is likely to maintain a hawkish stance which would limit the upside in stocks, but cheap valuations in the HSI (2022E P/E at 10.1X) should offer downside protection.
- **Sector rotation:** We are turning **relatively bullish on value stocks over growth stocks**. Chinese state-owned banks lowered deposit interest rates last week, which we believe is a signal for credit loosening in China and increases the possibility of loan rate cuts in the next 2-3 months. These should be positive for cyclical sectors such as property & infrastructure. Technical signals show that growth stocks in China / HK have turned weak relatively to value stocks, breaking a short-term uptrend (Fig. 1), and value sectors including Financials, Materials, Telecom & Property have moved into the "Leading" zone on a daily Relative Rotation Graph (Fig. 2).
- **Things to watch this week:**
 - Tuesday: China's LPR (Loan Prime Rate).
 - Wednesday: US Fed's interest rate decision and interest rate "dot plot".
 - Thursday: Bank of England's & Bank of Japan's interest rate decisions.
 - Friday: S&P Global Manufacturing PMI (Sep preliminary).

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

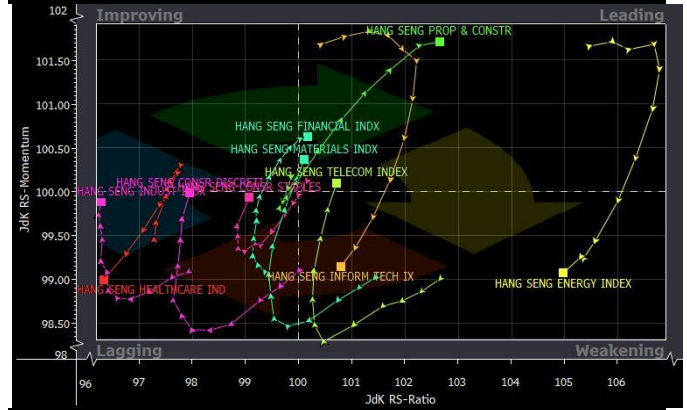
Charts of the Week

Figure 1: China Growth stocks underperformed Value in recent weeks, breaking a short-term uptrend



Source: Bloomberg, CMBIGM

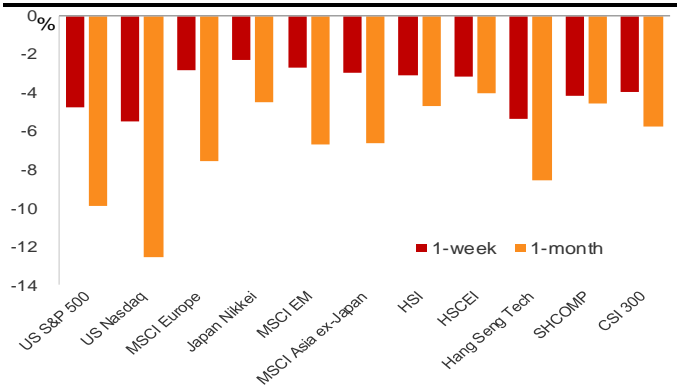
Figure 2: Value sectors under HSCI are in "Leading" zone in daily Relative Rotation Graph, indicating relatively strong momentum



Source: Bloomberg, CMBIGM

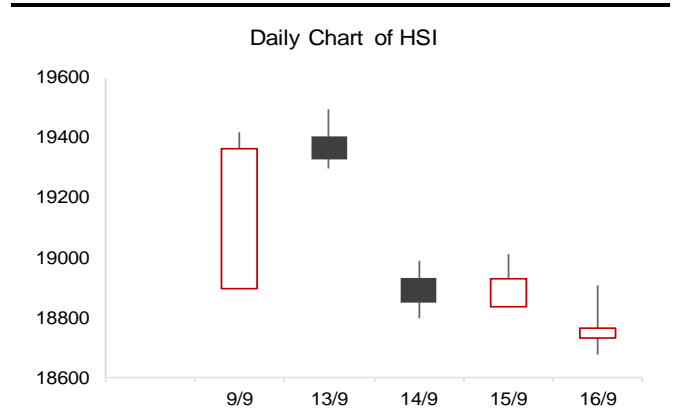
Market Recap

Figure 3: Weekly global markets' returns: Weakness around the globe amidst stagflation fears



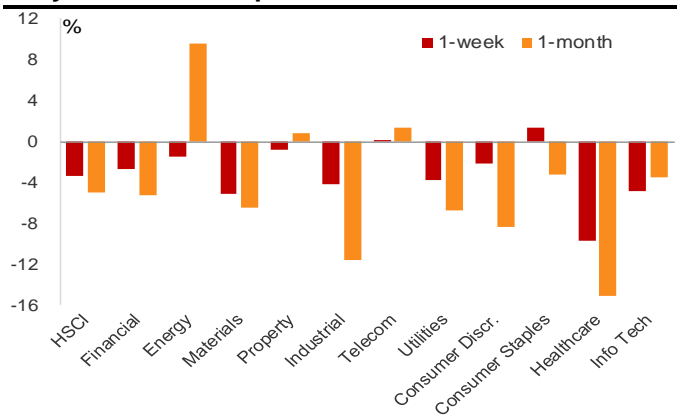
Source: Bloomberg, CMBIGM

Figure 4: HSI fell to below 19,000 again



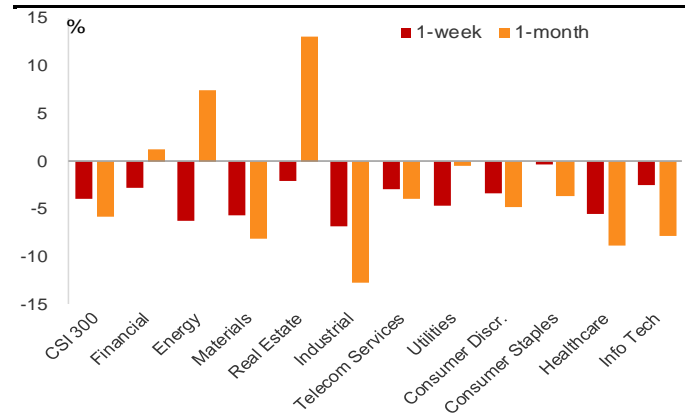
Source: Bloomberg, CMBIGM

Figure 5: Hang Seng Composite Index sectors: Only Consumer Staples & Telecom rose last week



Source: Bloomberg, CMBIGM

Figure 6: CSI 300 Index sectors: Every major sector declined last week



Source: Bloomberg, CMBIGM

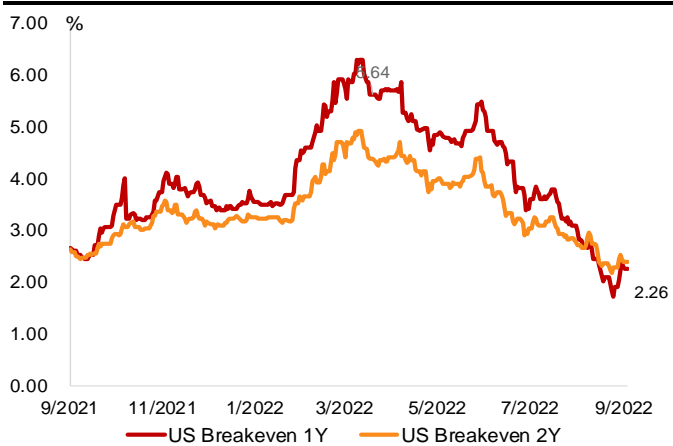
Figure 7: US Growth stocks outperformed Value since May but pulled back lately on higher rates



Source: Bloomberg, CMBIGM

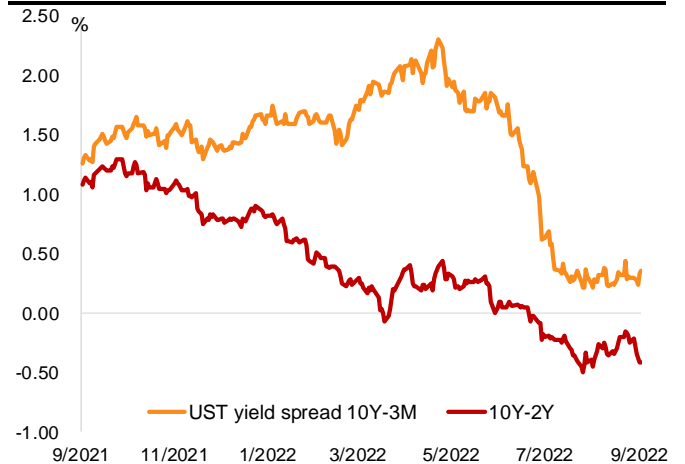
Fund Flows

Figure 8: US inflation expectations easing since Apr



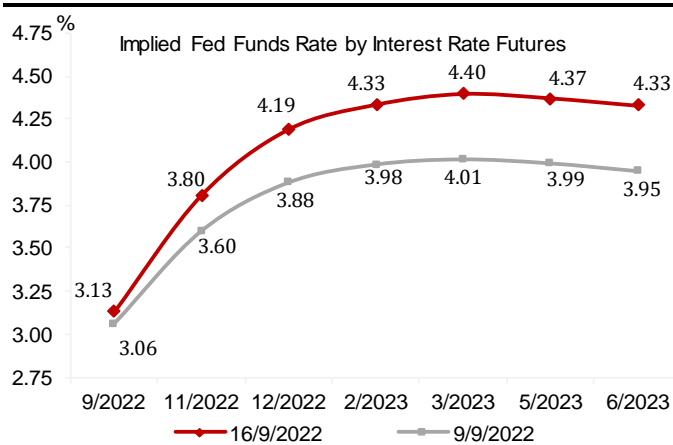
Source: Bloomberg, CMBIGM

Figure 9: UST 10-yr & 2-yr spread is negative



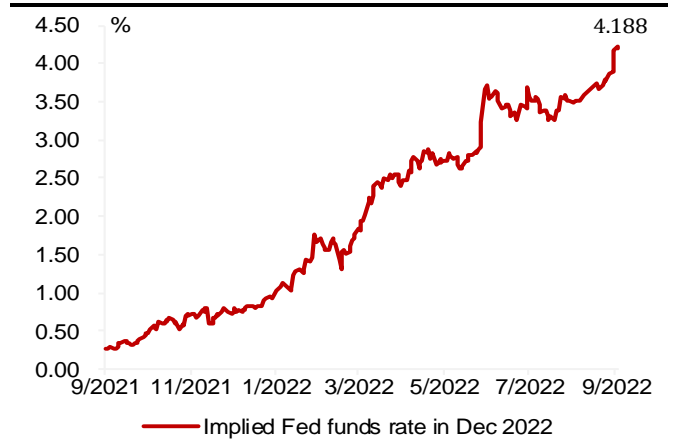
Source: Bloomberg, CMBIGM

Figure 10: Fed rate hike concerns deepened significantly last week



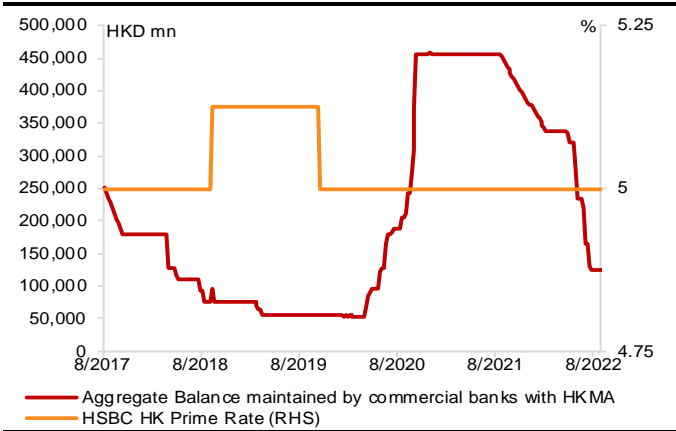
Source: Bloomberg, CMBIGM

Figure 11: Implied Fed funds rate in Dec 2022 surged to another new high



Source: Bloomberg, CMBIGM

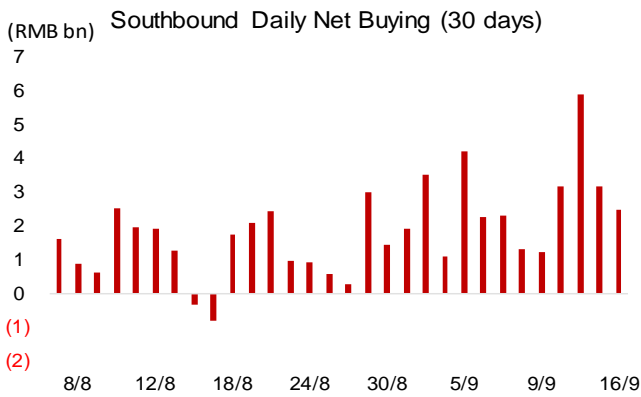
Figure 12: HKMA aggregate balance remained at around HK\$125bn over the past four weeks. Commercial banks might raise lending rates when this drops to below HK\$100bn



Source: Bloomberg, CMBIGM

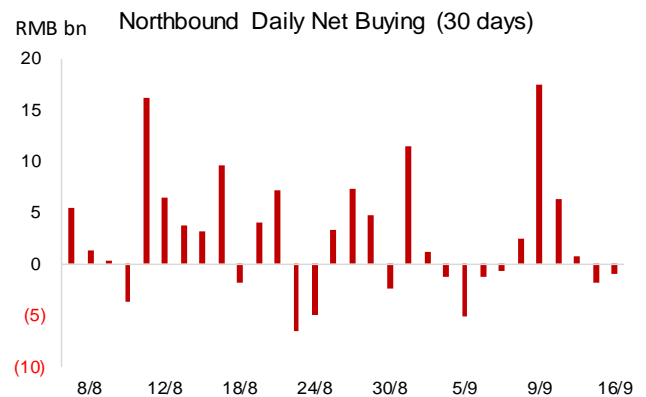
SH/SZ-HK Stock Connect

Figure 13: Southbound inflows increased last week



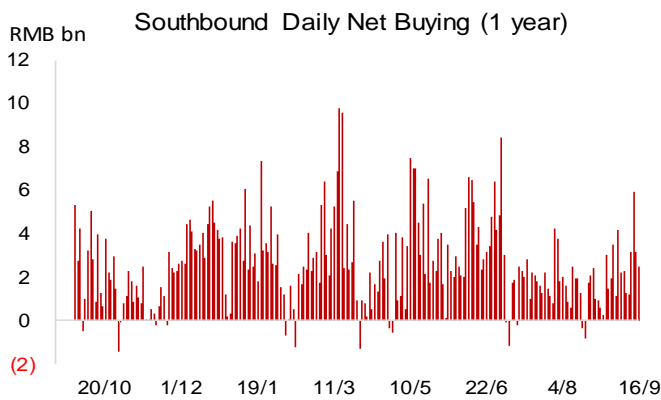
Source: Bloomberg, CMBIGM

Figure 14: Northbound inflows were more volatile



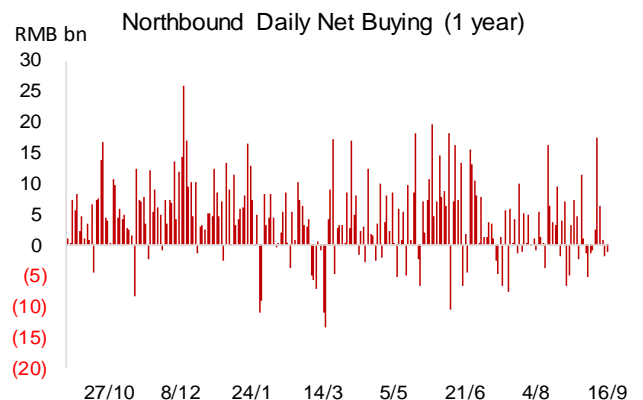
Source: Bloomberg, CMBIGM

Figure 15: Southbound net buying rebounding in Sep from low levels in Jul-Aug



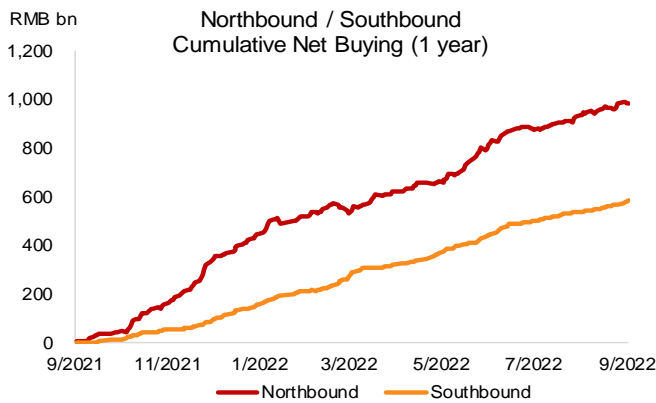
Source: Bloomberg, CMBIGM

Figure 16: Northbound net buying slowed down in 3Q 2022



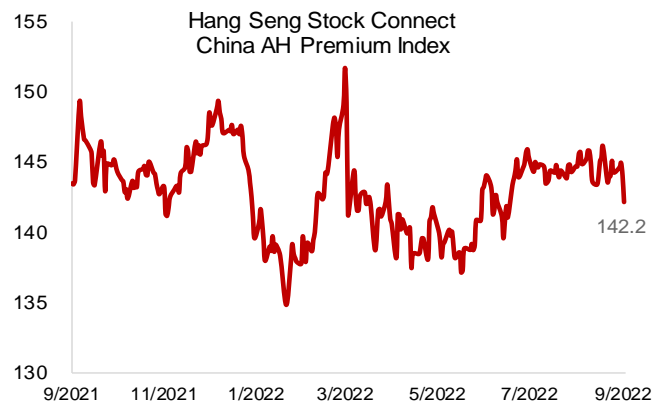
Source: Bloomberg, CMBIGM

Figure 17: Northbound & Southbound cumulative inflows in the past 12 months



Source: Bloomberg, CMBIGM

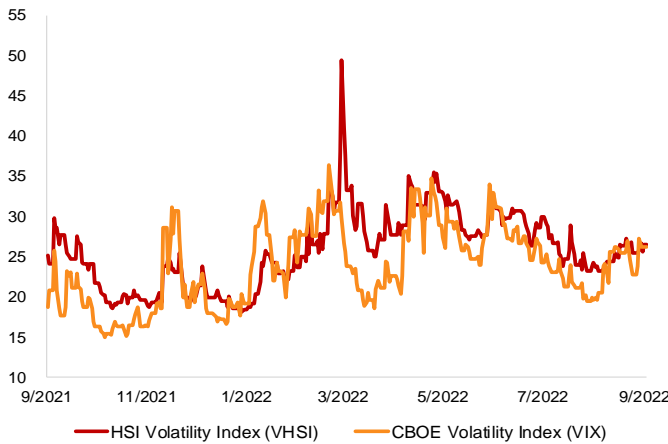
Figure 18: AH premium narrowed by 2.1 ppt last week as A-shares underperformed



Source: Bloomberg, CMBIGM

Sentiments

Figure 19: "Fear Indices" VHSI & VIX rebounded last week as stock markets declined



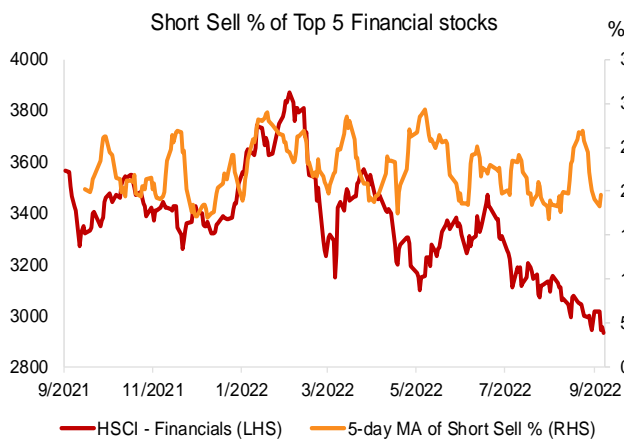
Source: Bloomberg, CMBIGM

Figure 20: Short sell % on HK mainboard retreating from record high in late-Aug



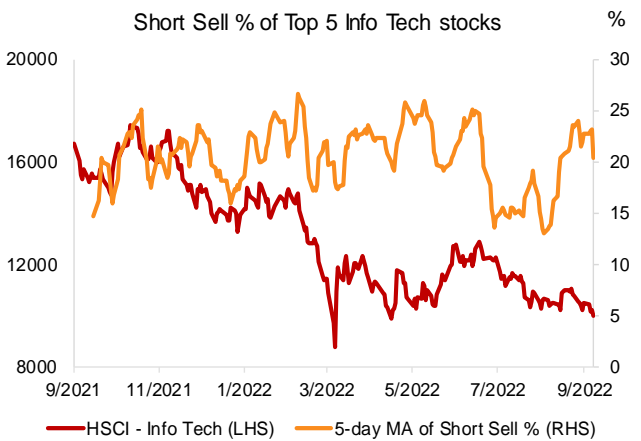
Source: Bloomberg, CMBIGM

Figure 21: Short sell % in HK - Financials



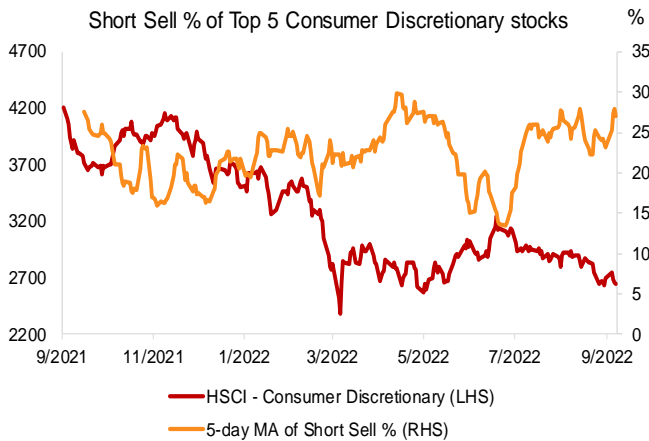
Source: Bloomberg, CMBIGM

Figure 22: Short sell % in HK - Info Tech



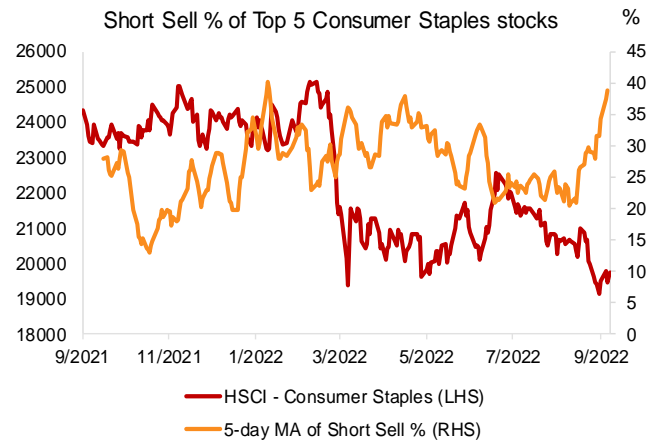
Source: Bloomberg, CMBIGM

Figure 23: Short sell % in HK – Consumer Discretion.



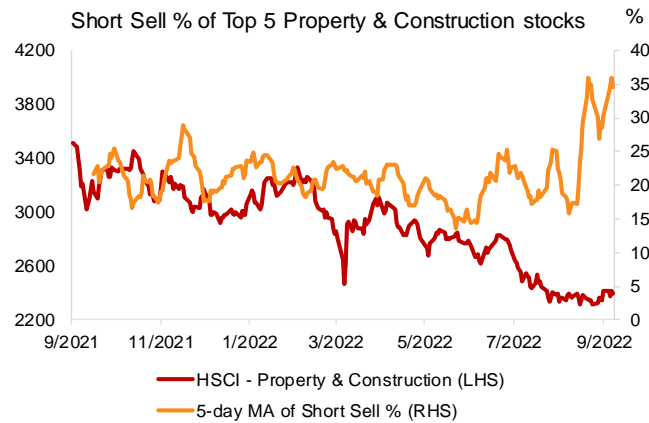
Source: Bloomberg, CMBIGM

Figure 24: Short sell % in HK – Consumer Staples



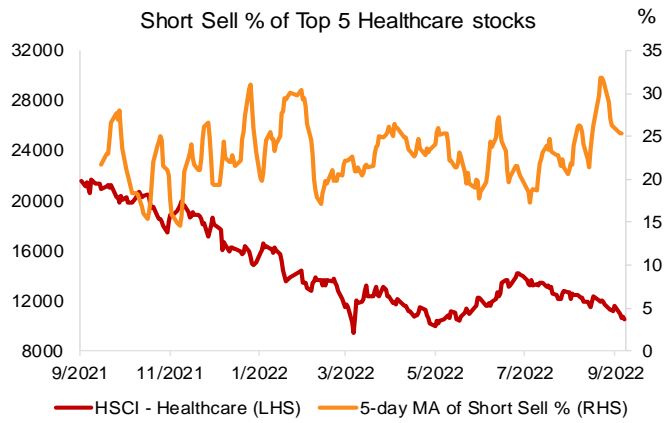
Source: Bloomberg, CMBIGM

Figure 25: Short sell % in HK - Property



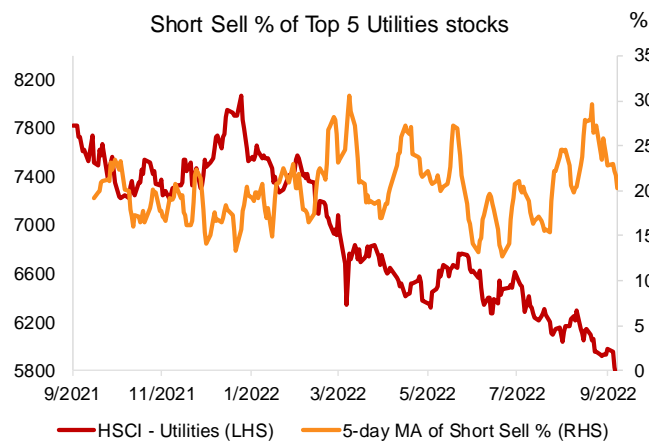
Source: Bloomberg, CMBIGM

Figure 26: Short sell % in HK – Healthcare



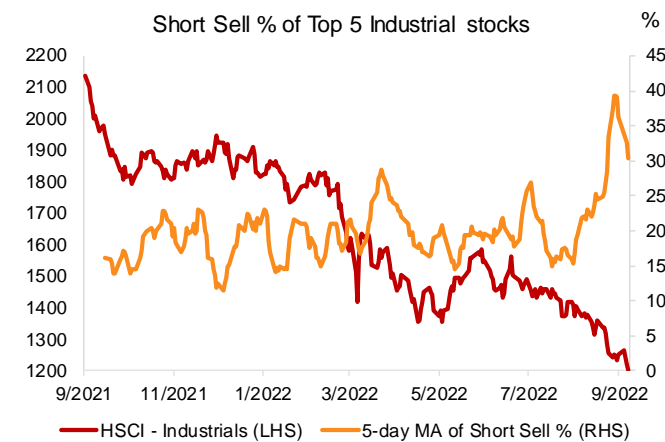
Source: Bloomberg, CMBIGM

Figure 27: Short sell % in HK – Utilities



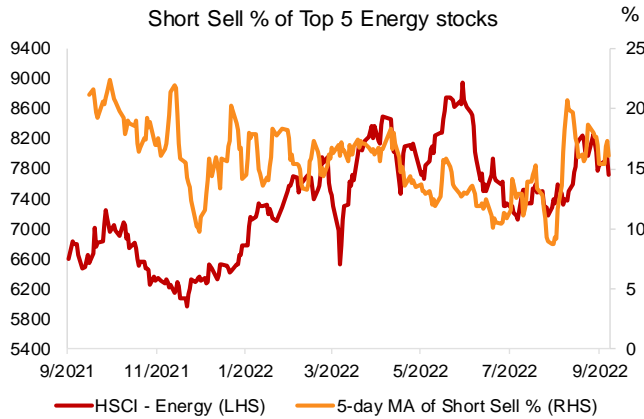
Source: Bloomberg, CMBIGM

Figure 28: Short sell % in HK – Industrials



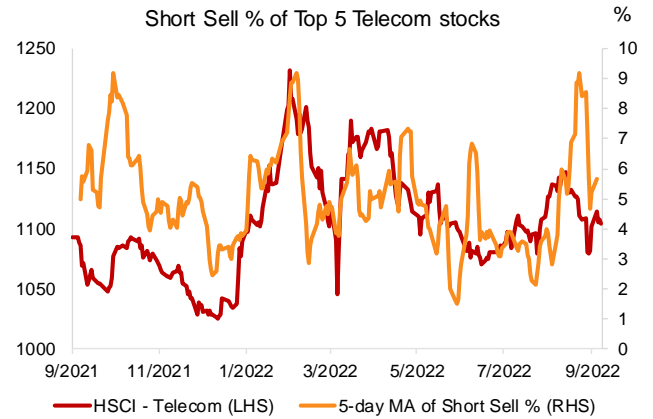
Source: Bloomberg, CMBIGM

Figure 29: Short sell % in HK – Energy



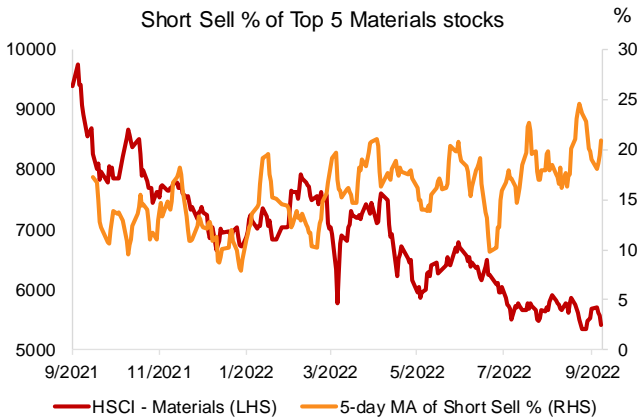
Source: Bloomberg, CMBIGM

Figure 30: Short sell % in HK – Telecom



Source: Bloomberg, CMBIGM

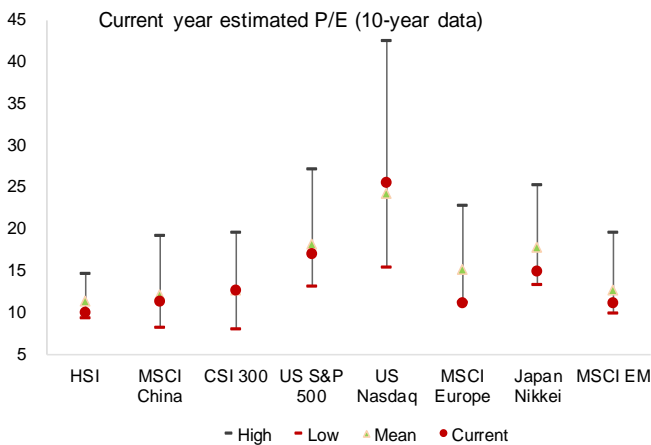
Figure 31: Short sell % in HK – Materials



Source: Bloomberg, CMBIGM

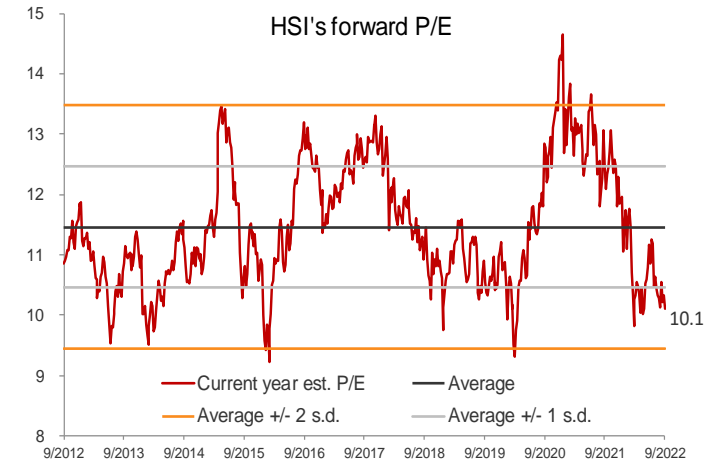
Earnings & Valuations

Figure 32: Major stock markets' forward P/E vs. 10-yr history



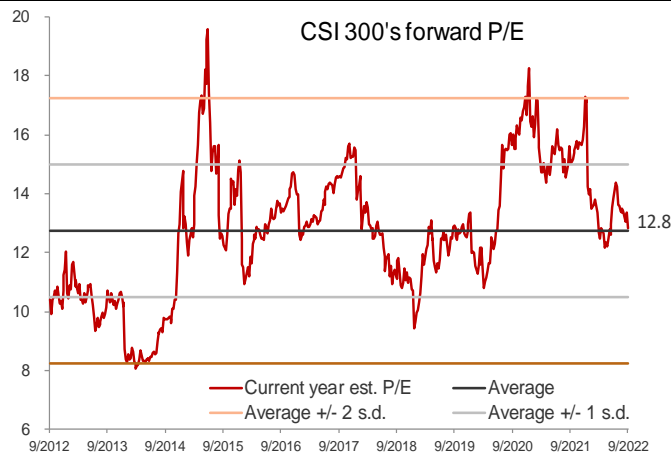
Source: Bloomberg, CMBIGM

Figure 33: HSI's forward P/E below 10-yr mean by more than 1 s.d.



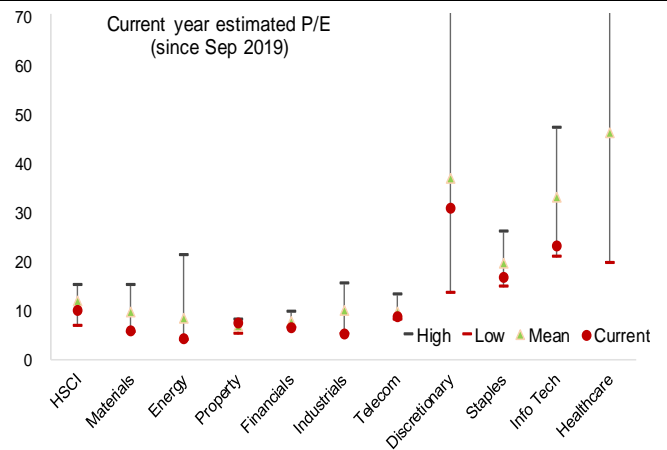
Source: Bloomberg, CMBIGM

Figure 34: CSI 300's forward P/E above 10-yr mean



Source: Bloomberg, CMBIGM

Figure 35: Many HSCI sectors' P/E are near troughs



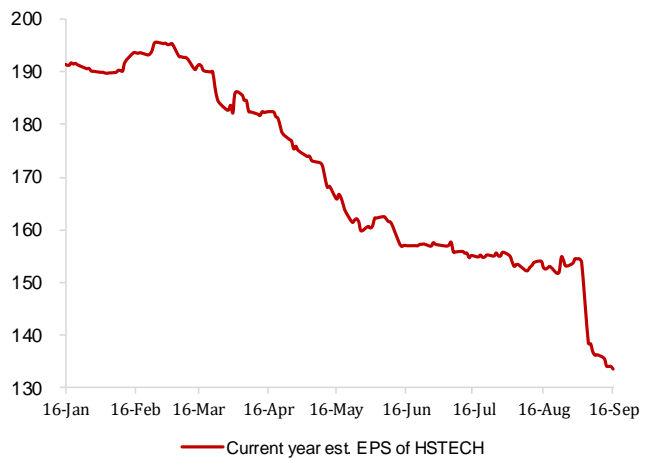
Source: Bloomberg, CMBIGM

Figure 36: EPS estimates of HSI were revised down by 0.9% last week, with Property, Financials & Industrials the main drag



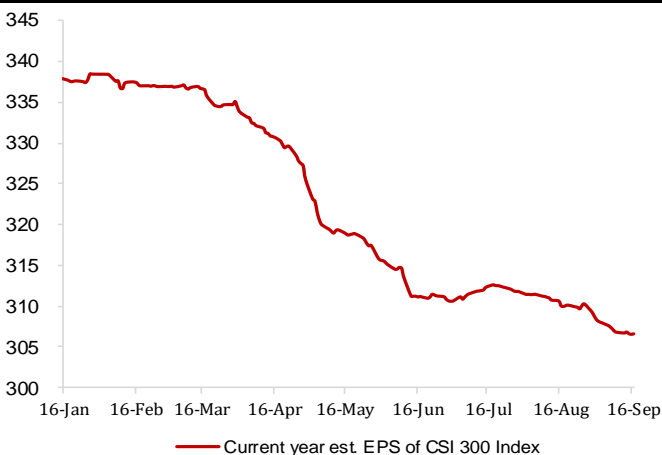
Source: Bloomberg, CMBIGM

Figure 37: EPS estimates of HSTECH Index were down by 2.0% last week



Source: Bloomberg, CMBIGM

Figure 38: EPS estimates of A-shares were little changed last week



Source: Bloomberg, CMBIGM

Figure 39: EPS estimates of US S&P 500 were tuned down by 0.1%, and 1.5% off the peak in Jul



Source: Bloomberg, CMBIGM

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

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