17 December 2018

Strategy - Hong Kong

Range Trading Ahead, Favouring Policy Beneficiaries

Stocks Covered:	80
Ratings (Buy/Neutral/Sell):	50/22/8

While the prolonged trade war and China's economic slowdown are widely regarded as the major uncertainties in 2019, we should not overlook that it is largely factored into the HSI's valuation. We reiterate our view that more stimulus from the Chinese Government is likely going into 2019. Overall, in 2019, we expect to see a continued see-saw sentiment and the HSI to trade sideways between 25,000 and 28,000 pts. We are positive on the China railway and property sectors as they are beneficiaries of the supportive policy front. We also suggest accumulating Tencent on its strong outlook of advertising income.

China economy in 2019: Supporting growth emerges as the top priority. We expect the Government's key objective is to ensure a soft landing for the anticipated economic slowdown. This is done by more accommodative fiscal policies and softened, yet not abandoned, financial deleveraging. Potential new or enhanced stimuli include a wider range of tax cuts, loosening restrictions on local government bond issues, more relaxed policy stance on property markets, further monetary policy loosening and continued CNY weakness.

Trim 2019 China GDP forecast. While the positive frontloading factor has come to an end, we think it is consensus for a slowing China's real GDP growth in 2019. We revise our base-case forecast to 6.3% from 6.4% for 2019F. If China and the US fail to reach an agreement and enter into a full-blown trade war, China's real GDP growth in 2019, at worst, should decline to 5.0% – assuming a price elasticity of 0.5 on China's exports to US.

Continued range trading for HSI amid see-saw sentiment ahead. We believe the major uncertainties have largely been priced in by now; HSI is currently trading at 10.1x P/E, roughly -1SD from its 10-year mean. Going forward, we believe the HSI will continue to trade sideways in 2019, with the trading range between 25,000 and 28,000 pts (-0.5 to -1.0SD, 10x to 11x P/E). We expect to see a continued see-saw sentiment, at least in 1Q19.

In a bull-case scenario of a meaningful compromise between the US and China, we forecast a 30,000 pts target (-0.25SD, 11.6x P/E), which demonstrates a rebound of HSI valuation to the level roughly before the trade war occurred. On the contrary, in the extreme case of a full-blown trade war and faster-than-expected deterioration of China's economic growth, we reckon a bear-case scenario of 22,000 pts (-1.5SD, 8.6x P/E) target.

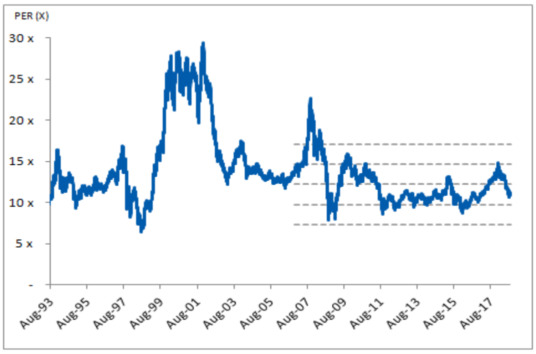
Overweight China railway and property sectors as they remain the beneficiaries of the favourable policy front. Following the clean-up of unqualified PPP projects completed in 3Q2018, we reckon Government's new regulations will accelerate PPP investment growth. Coupled with a potential VAT cut in 2019F, we believe construction players and, in particular railway names, might post positive earnings surprise. Our top pick is CRCC.

For China property, we see continuing loosening signs, including relaxed regulations on onshore bond issuance and declining mortgage rates. We continue to prefer large-scale players with strong ROEs and manageable debt burdens. Our top pick is Shimao Property.

Buy Tencent. Despite slowing revenue from online games, we continue to like Tencent, given its strong outlook for advertising business which will be the core growth driver, together with its undemanding valuation at 24.7x FY19F P/E.

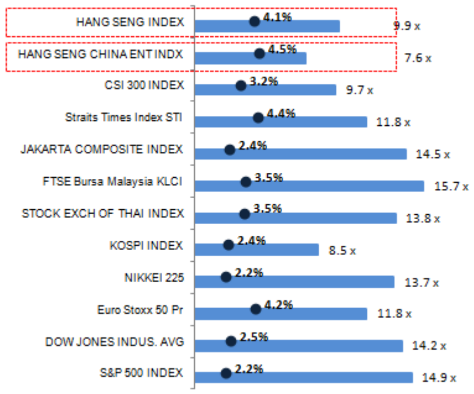
Top Picks	Target Price
CRCC (1186 HK) – BUY	HKD12.50
Shimao (813 HK) – BUY	HKD30.80
Tencent (700 HK) – BUY	HKD390.0

HSI to trade between 25,000 - 28,000 pts (10x - 11x P/E)



Source: Bloomberg, RHB

Major Indices' 12M forward P/E & dividend yield



Source: Bloomberg, RHB

Company Name	Rating	Price (HKD)	Target (HKD)	%Upside (Downside)	P/E (x) Dec-19F	P/B (x) Dec-19F	Yield (%) Dec-19F
CHINA RAILWAY CONSTRUCTION	BUY	10.9	12.5	14.7%	5.32	0.71	2.9%
SHIMAO PROPERTY HOLDINGS	BUY	21.2	30.8	45.6%	4.50	0.83	8.9%
TENCENT	BUY	308.8	390.0	26.3%	24.68	8.07	0.1%
CHINA RAILWAY GROUP	BUY	7.4	7.7	3.9%	6.95	0.84	2.1%
COUNTRY GARDEN HOLDINGS	BUY	9.6	20.0	108.3%	3.99	1.40	8.8%
GREAT WALL MOTOR CO	SELL	4.7	3.7	-21.9%	4.75	0.64	6.3%

Source: Company data, RHB

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2019 China Economic Outlook

Supporting growth emerges as the top priority

HK/China stock markets and business confidence have been retreating YTD in reaction to the downside pressure brought by the central government's financial deleveraging campaign and the prolonged trade tensions with the US. We trim our China's real GDP growth forecast to 6.3% from 6.4% for 2019F, and we further estimate an extreme downside case scenario of 5% in the case of a full-blown trade war if China and US governments failed to reach a deal after the 90-day grace period that began on Dec 2018.

In 2019, we expect China Government's key objective is to support economic growth and ensure a soft landing for the anticipated economic slowdown. This will be done by more accommodative fiscal policies, as well as softened yet not abandoned financial deleveraging campaign. We foresee the following actions are most likely to occur:

1. Given the significance of consumption to the GDP growth, we expect a wide range of tax cuts, including tax on personal income, VAT, corporate income tax, etc, will be further announced to drive personal and corporate spending.
2. Infrastructure will also pay a more significant role with loosening restrictions on local government issuance of special purpose bonds.
3. Coupled with a more relaxed policy stance on the property sector, we anticipate real estate investment and infrastructure to regain momentum and drive gross capital formation.
4. Meanwhile, we anticipate PBoC to undergo further rounds of RRR reduction to maintain sufficient liquidity in the real economy and more specifically to channel lending towards private companies and SMEs.
5. Last but not least, we anticipate the CNY weakness to persist and cushion the impact of tariffs, even though we do not see a sharp depreciation similar to the one in 2015 to materialise to avoid triggering panic and massive capital outflows.

Figure 1: Summary of RHB's economic forecasts

	2015	2016	2017	2018F	2019F
Real GDP growth (%YoY)	6.9	6.7	6.9	6.6	6.3
Nominal export growth (%YoY)	-2.8	-7.7	7.9	11.0	4.7
Nominal import growth (%YoY)	-14.1	-5.5	15.9	17.9	7.2
Trade balance (USD bn)	594.5	510.0	422.5	348.1	272.8
Industrial production growth (%YoY)	6.1	6.0	6.6	6.3	5.8
Fixed asset investment	10.0	8.1	7.2	5.9	5.3
Retail sales growth (%YoY)	10.7	10.4	10.2	9.3	8.9
M2 (%YoY)	13.3	11.3	8.2	8.3	8.4
CPI (%YoY)	1.4	2.0	1.6	2.2	2.4
PPI (%YoY)	-5.2	-1.4	6.3	3.7	1.3
USD/CNY	6.49	6.94	6.53	6.92	6.94

Source: WIND, RHB

Trade tension with the US intensifies downside pressure

Whilst trade figures remained strong with export value growing at 8.2% YTD, it appears to us that exporters are frontloading their orders. In fact, as per the official PMI new export order sub-index, the figure retreated from 51.2 in May to 47.0 in November. The 50-point mark is widely considered as a neutral territory, indicating no growth in activity or even a contraction on a monthly basis.

As of today, the US has imposed tariffs on a total of USD250bn worth of Chinese imports which could potentially be raised to USD517bn. China, meanwhile, has imposed on USD110bn imports from the US and could possibly increase the amount to USD150bn. On 1 Dec 2018, President Trump and Xi agreed on a 90-day truce, to finalise a deal between China and US, which involves China to commit buying a very substantial amount of US exports, including agricultural, energy, industrial and other products. If the US and China fail to reach an agreement, US will raise the existing 10% tariff to 25% over USD200bn imports from China, and might also consider new tariffs on all of the remaining USD267bn imports from China.

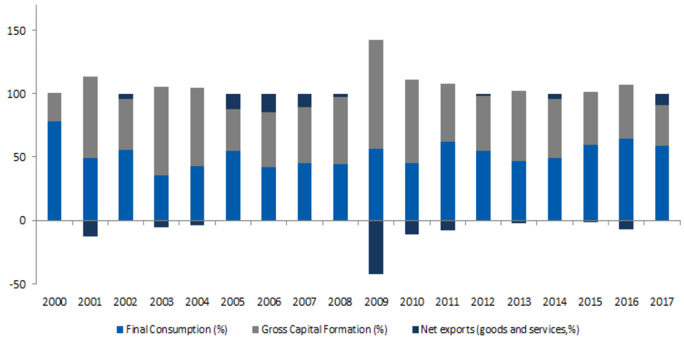
The recent arrest of Huawei Technologies CFO, Meng Wanzhou in Canada, at the request of US authorities who alleged Meng conspired to defraud banks to violate US sanctions by clearing transactions linked to Iran – despite a bail which was granted by the Canadian court – does not help the situation. Overall, we see an increasing tension between the US and China which clearly adds more downside risk to the Chinese economy.

Based on our estimates, should China and the US fail to reach an agreement after the 90-day grace period and enter into a full-blown trade war, China's real GDP growth in 2019, at worst, will decline to 5.0% – assuming the price elasticity on China's export to US is 0.5. At the extreme, but unlikely scenario, assuming the price elasticity on China's exports to US is 1.0, we expect the lowest possible GDP growth for China at 3.8%.

Figure 2: Exports to the US as % of China's GDP

Source: NBS, WIND, RHB

Figure 3: Export's contribution to China's GDP growth (%)



Source: CEIC, NBS, WIND, RHB

Tax cut to boost consumption

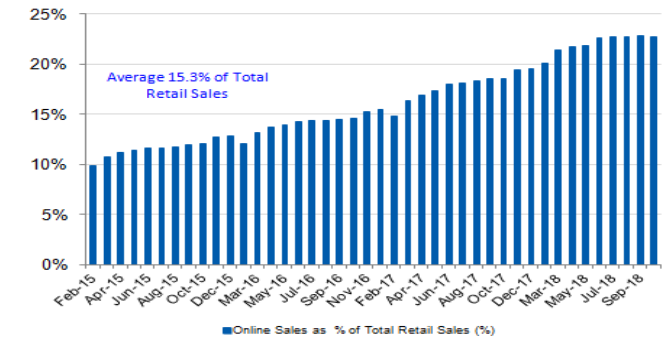
In 2018 YTD, China's Government already rolled out CNY1.3trn in tax reductions, which include CNY240bn VAT, CNY113bn tax rebate, CNY100bn export tax rebate, etc. Whilst the impact on the real economy has yet to be seen, we anticipate the Government to further cut corporate and personal income taxes which will be conducted through raising the threshold for collecting individual income tax – currently at CNY5,000/month – and reducing VAT and other fees for companies. We also believe it is possible for the Chinese Government to consider lowering the 25% corporate income tax rate.

Given the declining contribution on economic growth from exports and considering the looming debt balance of the country, there is little room for the Chinese Government to conduct an all-out financial stimulus to support and accelerate infrastructure spending. As such, we anticipate tax cuts will be a more possible and impactful tool in 2019.

Figure 4: China Retail Sales Growth

Source: NBS, WIND, RHB

Figure 5: Online Sales % Retail Sales



Source: CEIC, NBS, WIND, RHB

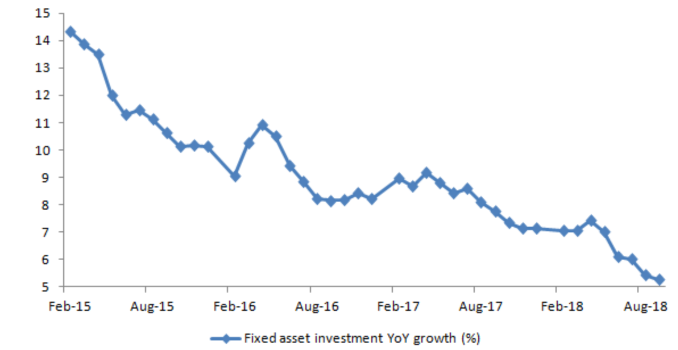
Infrastructure and property investment probably regain momentum

We believe local government bond issuance is likely to be loosened in 2019 to spur growth in infrastructure spending and offset the anticipated slowdown in government income due to the tax cuts. That said, we believe part of the proceeds from these new issuances will be allocated for refinancing of old debt that amounted to CNY1.3trn (vs CNY840trn in 2018). Some experts forecast that to spur growth in infrastructure, local governments will have to issue a total of CNY3.9-4.4trn general (on-budget) bonds and special purpose (off-budget) bonds. However, we believe the room for further fiscal expansion is limited as it will cause the leveraging level to rise further, ruining the financial deleveraging effort in 2018 and extending the systematic risks.

Meanwhile, we anticipate a more relaxed credit environment entering 2019 will stimulate real estate investments as well as maintain stable home prices.

Overall, we anticipate rebounding FAI growth thanks to more favourable policies. Nevertheless, we believe the recovery will be constrained, as a full-scale effort to stimulate infrastructure and real estate investment remains less likely given China's mounting debt level.

Figure 6: FAI Growth to Bottom Out



Source: NBS, WIND, RHB

Figure 7: REI Seeing Support from Increasing Credit

Source: CEIC, NBS, WIND, RHB

Further RRR reduction and CNY weakness to remain

On the monetary front, we anticipate the trend of RRR cuts will continue, while the Government will also continue to utilise open market and lending facilities to inject liquidity into the banking system and the real economy. As inflation remains contained below the 3% targeted level, we believe more aggressive RRR cuts will be on the cards in any worst case scenario.

We also anticipate CNY weakness to persist and cushion the impact from both existing and potential tariffs from US. Whilst the CNY depreciation is largely due to market forces, we believe the PBoC will only intervene when there is a sharp depreciation expectation which might trigger panic and massive capital outflows similar to 2015.

Market Overview

Overweight railway and property companies on favourable policy front

We reiterate our view that railway and property players will remain the beneficiaries of the favourable policy front as China's key objective in 2019 is to protect growth. As the Government continues to fast track railway investment and the clean-up of unqualified PPP projects was completed in 2018 Q3, the new regulations suggest that future PPP payment obligations will not account for local governments' hidden debt obligations and have reduced local government concerns. This should accelerate PPP investment growth. Coupled with a potential VAT cut in 2019F, we believe construction players and in particular railway names, might post positive earnings surprises. Our Top Pick for the construction sector is CRCC (1186 HK, BUY, TP: HKD12.50).

Meanwhile, we also reiterate our bullish view on the China property sector as we see continuing loosening signs which include relaxing regulations on onshore bond issuances, declining mortgage rates, and a more reasonable land market. These together should boost real estate investment, provide support to home prices and stimulate developers' property sales as well as new bond issuances. We continue to prefer large-scale players with strong ROEs and manageable debt burden. Our Top Picks are Shimao Property (813 HK, BUY, TP: HKD30.8), Country Garden (2007 HK, BUY, TP: HKD20.0) and CIFI (884 HK, BUY, TP: HKD7.9).

Tencent – Capitalise on the undemanding valuation

Despite slowing revenue growth from online game sales, we continue to like Tencent (700 HK, BUY, TP: HKD390.0) given its strong outlook for its advertising business which will be the core growth driver for the company. Coupled with an undemanding valuation at 24.7x FY19F P/E, we expect a more favourable macro environment will catalyse share price appreciation in the next 6 to 12 months.

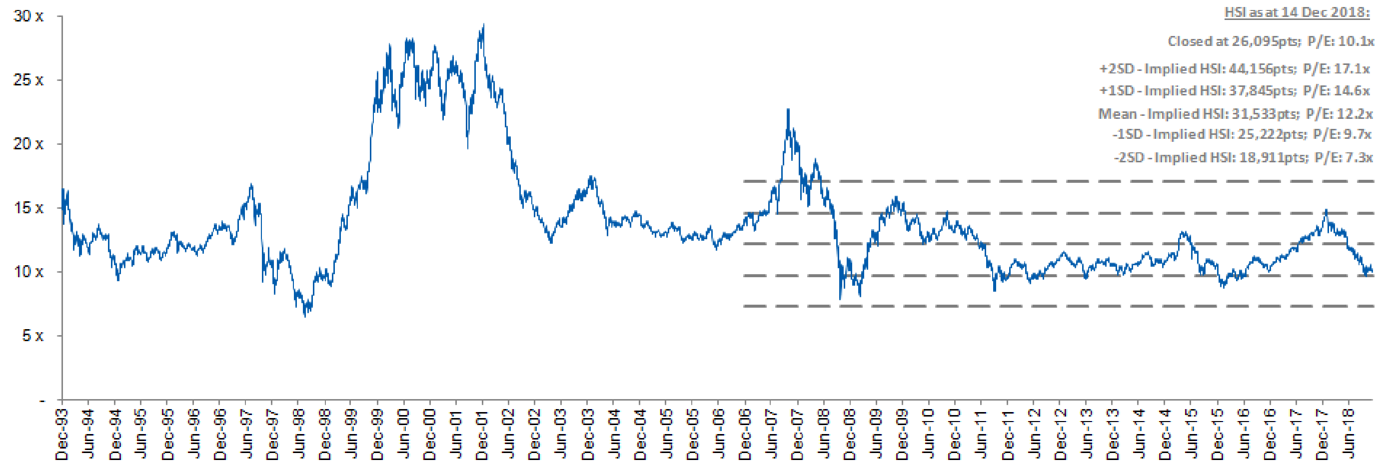
Index Valuation

Concerns on prolonged trade war and economic slowdown in China

We believe the major uncertainties in 2019 will still be surrounding trade tensions between China and the US as well as economic slowdown in China. However, we believe these have largely been priced in – HSI is trading at 10.1x P/E as at 14 Dec 2018, roughly -1SD from its 10-year mean.

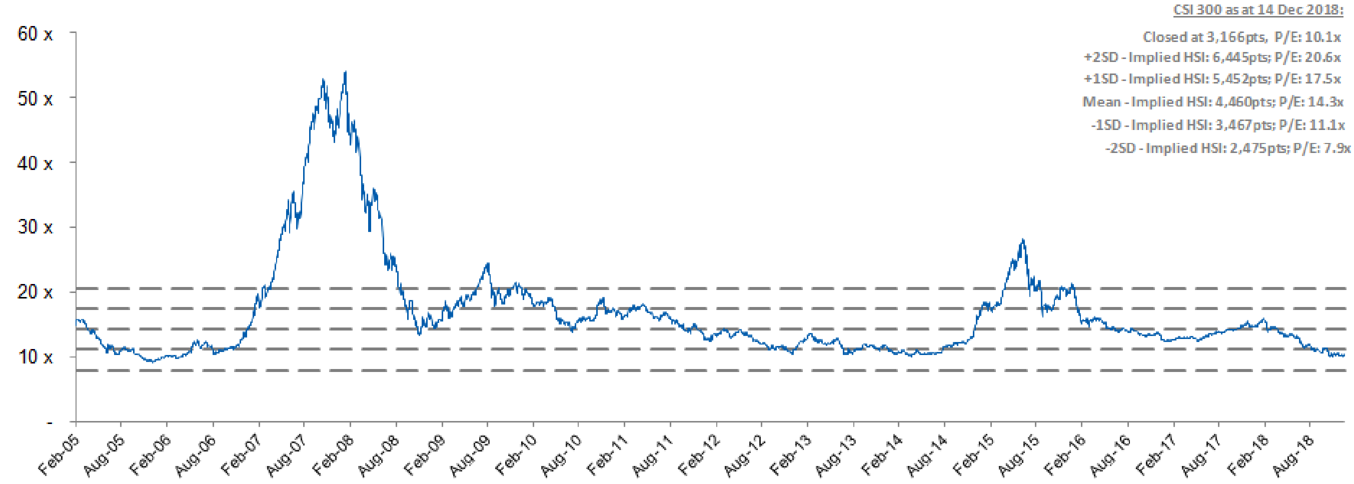
Going forward, we believe the HSI will continue to trade sideways in 2019, especially since we expect a continued see-saw sentiment in 1Q19. The trading range of HSI lies between 25,000 and 28,000 pts (-0.5 to -1.0SD, 10x to 11x P/E). In a bull-case scenario, if US and China are able to strike a compromise that ends the trade war, we forecast a 30,000 pts target (-0.25SD, 11.6x P/E), which shows a rebound of HSI valuation targeting a level roughly before the trade war occurred. On the contrary, in the extreme case of a full-blown trade war and faster-than-expected deterioration of China's economic growth, we reckon a bear-case scenario of 22,000 pts (-1.5SD, 8.6x P/E).

Figure 8: HSI and forward-rolling P/E band (1993 - YTD 2018)



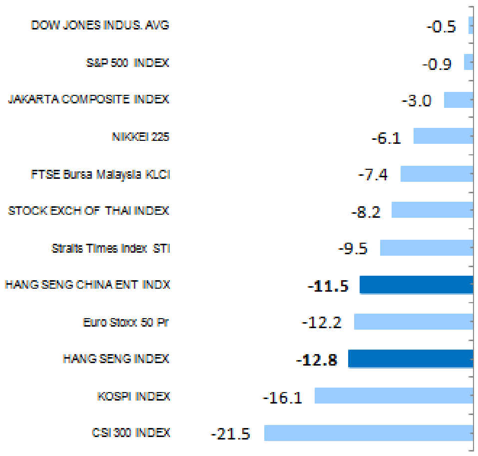
Source: Bloomberg, RHB

Figure 9: CSI300 and forward-rolling P/E band (2005 – YTD 2017)



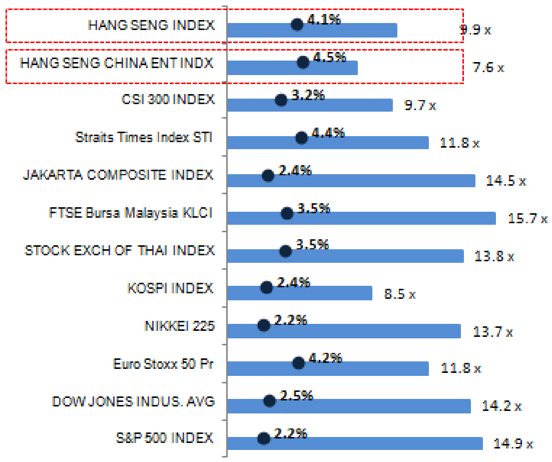
Source: Bloomberg, RHB

Figure 10: Major indices – YTD performance (%)



Source: Bloomberg, RHB

Figure 11: Major indices – 12M forward P/E and dividend yield



Source: Bloomberg, RHB

Figure 12: Comparison of major indices

INDEX	Price	2017 performance	2018 YTD performance	FY18F P/E	FY19F P/E	FY18F EPS YoY%	FY19F EPS YoY%	3-Yr EPS Cagr (%)	FY18F P/BV (x)	FY19F P/BV (x)	FY18F Div Yield (%)	FY19F Div Yield (%)
HANG SENG INDEX	26,095	36.0	(12.8)	10.5	9.9	(5.7)	6.1	3.1	1.2	1.1	3.8	4.1
HANG SENG CHINA ENT INDX	10,359	24.6	(11.5)	7.9	7.6	2.3	3.8	5.1	1.0	0.9	4.1	4.5
CSI 300 INDEX	3,166	21.8	(21.5)	10.6	9.7	10.1	9.6	11.5	1.4	1.3	2.9	3.2
Straits Times Index STI	3,079	18.1	(9.5)	12.1	11.8	(5.4)	2.4	1.4	1.1	1.0	4.2	4.4
JAKARTA COMPOSITE INDEX	6,165	17.8	(3.0)	15.7	14.5	25.4	8.3	14.7	2.4	2.2	2.2	2.4
FTSE Bursa Malaysia KLCI	1,664	9.4	(7.4)	16.4	15.7	15.8	4.4	8.6	1.7	1.6	3.4	3.5
STOCK EXCH OF THAI INDEX	1,609	13.7	(8.2)	14.9	13.8	(0.8)	7.8	5.1	1.9	1.7	3.2	3.5
KOSPI INDEX	2,069	21.8	(16.1)	5.9	8.5	68.9	(30.7)	8.9	0.9	0.8	2.3	2.4
NIKKEI 225	21,375	18.9	(6.1)	15.3	13.7	(3.5)	11.9	4.1	1.6	1.5	2.1	2.2
Euro Stoxx 50 Pr	3,076	7.1	(12.2)	12.5	11.8	10.4	5.7	8.3	1.5	1.4	4.0	4.2
DOW JONES INDUS. AVG	24,597	24.7	(0.5)	14.8	14.2	10.8	4.1	7.8	3.8	3.5	2.3	2.5
S&P 500 INDEX	2,651	18.9	(0.9)	15.6	14.9	16.3	4.3	10.2	3.0	2.8	2.1	2.2

Source: Bloomberg, RHB

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