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Fair Valuations Awaiting Turnaround Catalysts

We believe that a defensive approach and rangebound trading would still prevailing in the near term. Hence, we suggest that investors weigh on yield and domestic plays – broadly, China banks, telco, consumer and property sectors. Over the longer term, the index's valuation has retreated to an attractive level. Therefore, any turnaround in international and geopolitical events in 2H18 (or slightly earlier), as well as the implementation of the China A-shares' inclusion into MSCI Emerging Market Index in June, would probably trigger a market rebound, in our view. Sectors currently under pressure – particularly internet and handset components – are likely candidates for a recovery during that time. Yet, the accelerating inflation in the US and widening of the interest rate spread between the HKD and USD would be a major overhang going forward.

Near-term strategy – weigh on yield and domestic plays. YTD, consumer, bank and property sectors have outperformed and led the modest growth of the Hang Seng Index (HSI). This outperformance stem from these sectors' decent FY17 results. Aside from being domestic demand driven, they are principally immune from the US-China trade war tensions and volatile export data. Meanwhile, internet and handset components sectors have suffered from the global technology sector corrections and the outbreak of US-China trade war.

Going forward, given the cautious sentiment and the breather in southbound capital flow, we suggest investors lean towards the defensive nature of domestic and yield plays, in near term (until end-2Q18). For China banks, the upcoming dividend payout season could serve as a catalyst for the short term, and we view further monetary policy easing and the sector's attractive valuation as additional catalysts that would strengthen its fundamentals.

For China's property sector, despite a probable sideways trend in the near term until the interim results season commences, we suggest that investors focus on the beneficiaries of the Greater Bay Area (GBA) theme. This is as they are likely to announce development details in the coming weeks.

China's telco sector has been a laggard YTD, but China Mobile's (CM) 5% dividend yield (before potential special dividend) makes this stock a safe haven until the risk-on appetite prevails again. Also, the speculation on its quarterly dividend and further progress of the China Tower listing – CM is the largest shareholder, with a 38% stake – may also boost its share price in the near term.

Valuations have returned to fair levels. Following the 7% correction from an all-time high of 33,154 pts, the HSI is currently trading at 11.9x of its 12-month forward-rolling P/E. This indicates that the index has roughly returned to its 10-year historical mean. While the earnings prospects of most of the sectors remain intact, we believe they lay the ground for a recovery – should any turnaround in international events take place later.

Stock picks. Agricultural Bank of China (ABC) and Bank of China (BOC) remain our Top Picks for China banks, given they have the lowest P/Es and highest yields among the Big-4 banks. For China's property sector, we identify Agile Property and Country Garden as the major beneficiaries of the GBA investment theme in near term. Also, we believe the solid fundamentals of Tencent and Geely remain intact, regardless of the recently-dimmed outlook of the internet, technology and auto sectors. This makes entry into both these stocks a desirable option now.

Company Name	Rating	Price	Target	% Upside (Downside)	P/E (x) Dec-18F	P/B (x) Dec-18F	Yield (%) Dec-18F
Agile Group Holdings	BUY	HKD16.18	HKD20.00	23.6	6.1	1.2	7.4
Agricultural Bank of China	BUY	HKD4.27	HKD5.80	35.8	5.6	0.7	5.5
Bank of China	BUY	HKD4.20	HKD5.90	40.5	5.6	0.7	5.5
China Mobile	BUY	HKD73.35	HKD100.00	36.3	10.2	1.2	4.9
Country Garden	BUY	HKD16.72	HKD22.00	31.6	9.0	2.4	3.9
Geely Automobile	BUY	HKD23.05	HKD29.00	25.8	13.8	3.7	1.4
Tencent Holdings Ltd	BUY	HKD411.00	HKD529.00	28.7	37.6	11.8	0.1

Source: Company data, RHB

Stocks Covered: 80
Ratings (Buy/Neutral/Sell): 50/ 21 / 9

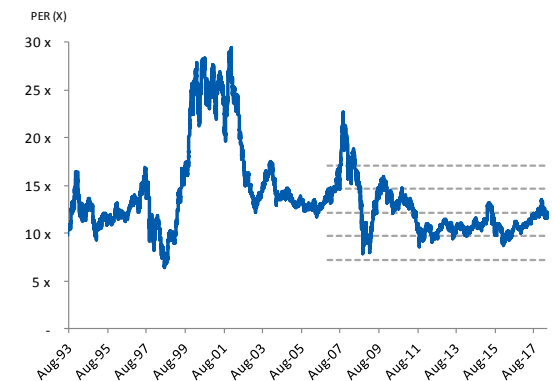
Top Picks

Tencent (700 HK) – BUY
Agricultural Bank of China (1288 HK) – BUY
Country Garden (2007 HK) – BUY

Target Price

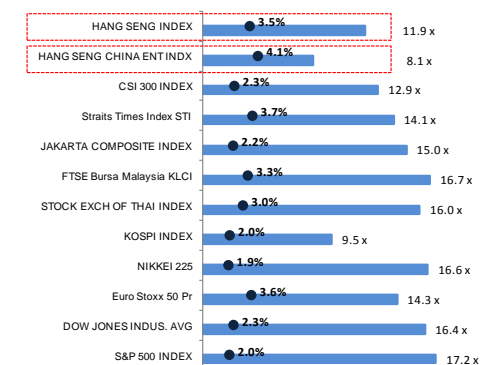
HKD529.00
HKD5.80
HKD22.00

HSI's valuation returned to a fair level



Source: Bloomberg

HK indices have among the lowest valuations globally



Source: Bloomberg

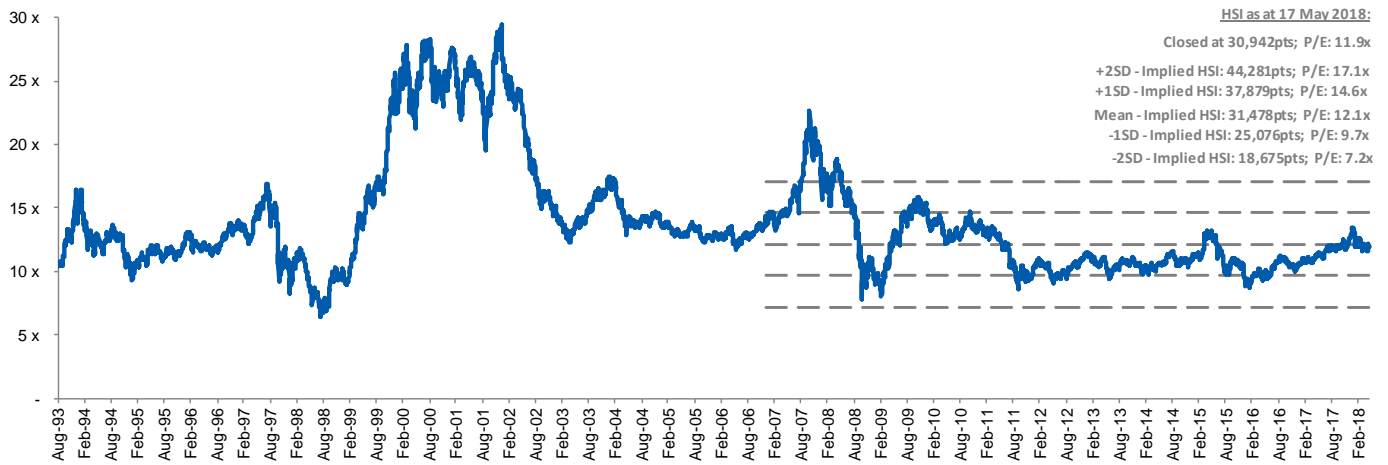
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Figure 1: HSI's rolling forward P/E (1993-2018 YTD)



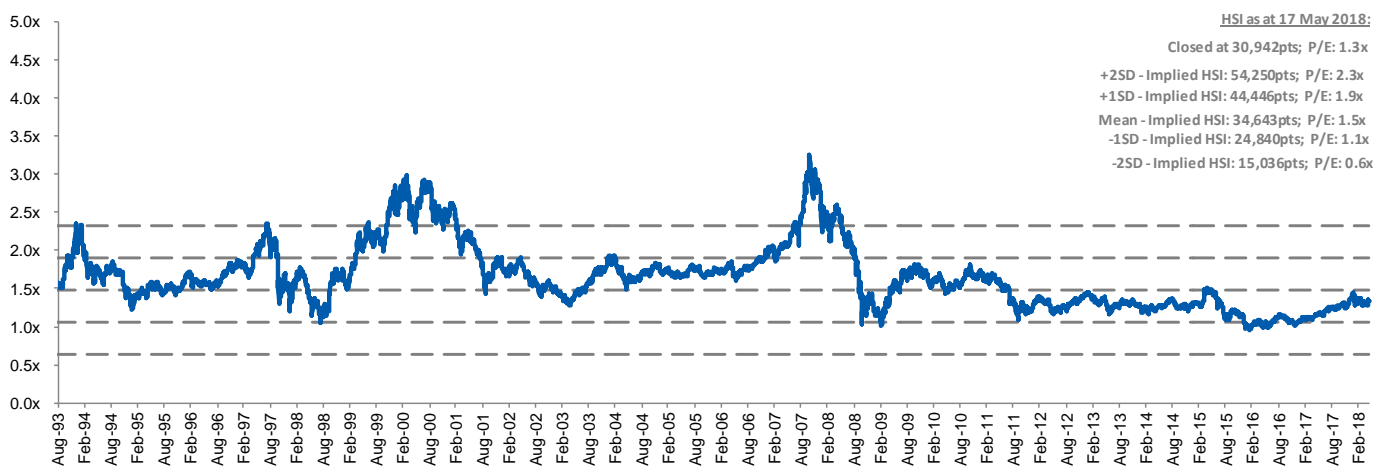
Source: Bloomberg, RHB

Figure 2: CSI 300's rolling forward P/E (2005-2018 YTD)



Source: Bloomberg, RHB

Figure 3: HSI's rolling forward P/BV (1993-2018 YTD)



Source: Bloomberg, RHB

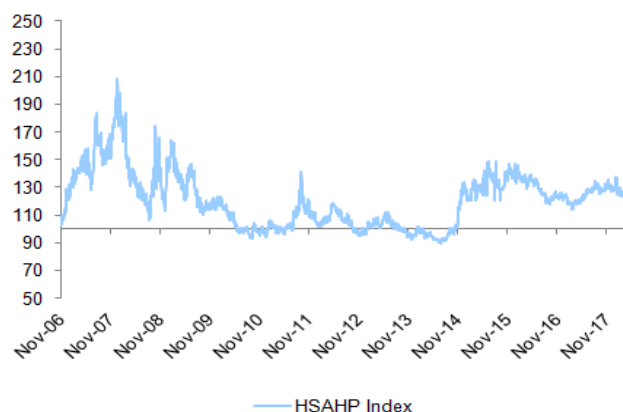
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Figure 4: Hang Seng China Enterprises Index's rolling forward P/E (2001-2018 YTD)



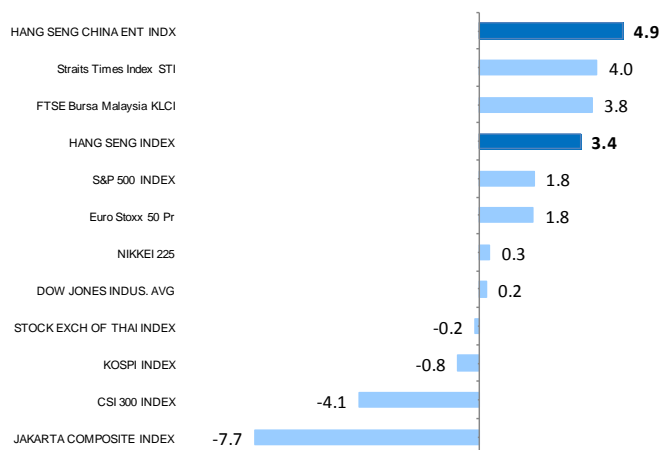
Source: Bloomberg, RHB

Figure 5: Hang Seng China AH Premium Index



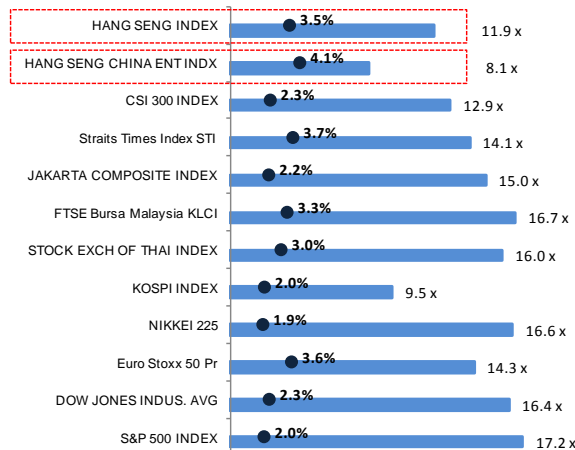
Source: Bloomberg, RHB

Figure 6: Major indices YTD performances (%)



Source: Bloomberg, RHB

Figure 7: Major indices 2018F P/E's and dividend yields



Source: RHB, Bloomberg

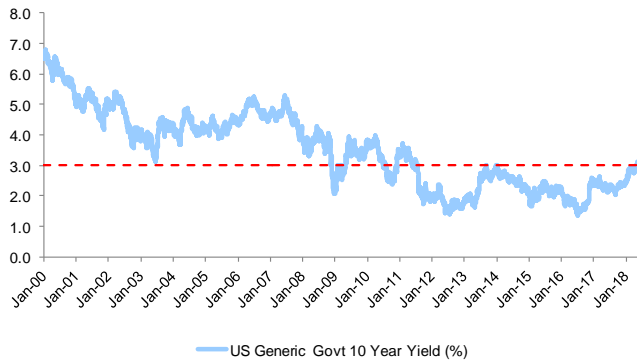
Figure 8: Comparison of major indices

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	30,942	36.0	3.4	11.9	10.8	5.9	10.4	9.0	1.3	1.2	3.5	3.7
HANG SENG CHINA ENT INDX	12,278	24.6	4.9	8.1	7.3	14.0	10.4	11.8	1.0	0.9	4.1	4.5
CSI 300 INDEX	3,864	21.8	(4.1)	12.9	11.2	14.3	15.1	15.1	1.7	1.5	2.3	2.6
Straits Times Index STI	3,538	18.1	4.0	14.1	12.9	(19.2)	8.7	(0.9)	1.2	1.2	3.7	3.9
JAKARTA COMPOSITE INDEX	5,867	17.8	(7.7)	15.0	13.4	40.6	12.0	19.4	2.3	2.1	2.2	2.5
FTSE Bursa Malaysia KLCI	1,865	9.4	3.8	16.7	15.6	1.9	7.4	4.9	1.7	1.6	3.3	3.5
STOCK EXCH OF THAI INDEX	1,750	13.7	(0.2)	16.0	14.6	11.0	9.4	9.6	2.0	1.9	3.0	3.2
KOSPI INDEX	2,448	21.8	(0.8)	9.5	8.8	25.3	8.2	12.6	1.0	1.0	2.0	2.1
NIKKEI 225	22,838	18.9	0.3	16.6	14.6	5.2	13.5	7.8	1.7	1.6	1.9	2.0
Euro Stoxx 50 Pr	3,567	7.1	1.8	14.3	13.1	12.2	9.6	10.0	1.6	1.5	3.6	3.8
DOW JONES INDUS. AVG	24,769	24.7	0.2	16.4	15.0	14.3	8.8	10.5	3.8	3.5	2.3	2.4
S&P 500 INDEX	2,722	18.9	1.8	17.2	15.6	21.7	9.9	13.7	3.1	2.9	2.0	2.1

Source: Bloomberg, RHB

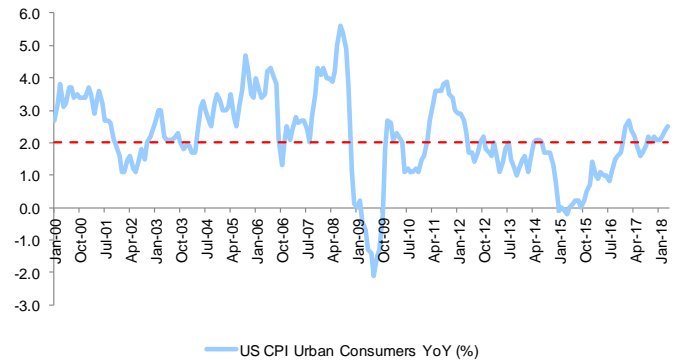
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Figure 9: US Generic Government's 10-year yield (2000-2018 YTD)



Source: Bloomberg, RHB

Figure 10: US CPI Urban Consumers YoY (2000-2018 YTD)



Source: RHB, Bloomberg

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Neutral: Share price may fall within the range of +/- 10% over the next 12 months

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