China/HK 2018 Market Outlook
Research Analysts :风险回报情况有利于价值型股票

基本展望结论：

We expect a flat market for MSCI China and Hang Seng Index, but some
upside in the H-share index, with more Old Economy value stocks.

我们预计MSCI中国和恒生指数将会持平，但有一些H股指数上涨，旧经济价值股更多。

■ Policy-induced uncertainty post 19th Party Congress. We expect the
government to seriously tackle some long-term structural problems in
2018, like shadow banking, public debt/de-leveraging, property policy,
supply side and SOE reform. During this process, there could be some
unintended and unfavourable impact on growth momentum.
■ Modest economic deceleration. We expect real GDP growth to slow
down from 6.8% in 2017 to 6.5% in 2018, PPI will drop to around 3% and
CPI will pick up to 2.5%. This growth slowdown would mainly be driven by
weakening export and infrastructure investment growth. Consumption and
industrial investment growth would be stable, while property investment
growth could pick up due to strong land sales in 2017.
■ Micro dominates when macro fades. Earnings growth momentum in
2018 will slow down along with nominal GDP growth, in our view. Mainland
liquidity now accounts for over 6% of the HK market turnover through the
two “Connect” schemes, and the ratio is expected to rise further. The US
market correction could be a risk to HK stocks, but the A-share market
could provide support through Mainland liquidity inflow. We believe MSCI
China and HSI will be flat in 2018, while HSCEI still offers around 13%
upside. Our biggest OVERWEIGHT is the China Banks sector, and the
biggest UNDERWEIGHTs are the China IT and Consumer Discretionary
sectors. Our top three picks for 2018 are BOC, Ping An and COLI. (See
pages 4 for our HK/China model portfolios and top picks.)

Risk reward profile favours value stocks
We expect a flat market for MSCI China and Hang Seng Index, but some upside in the Hshare
index, with more Old Economy value stocks.
Policy-induced uncertainty post 19th Party Congress
We expect the government to seriously tackle some long-term structural problems in 2018,
like shadow banking, public debt/de-leveraging, property policy, supply side and SOE
reform. During this process, there could be some unintended and unfavourable impact on
growth momentum. The clean-up of shadow banking activities will definitely involve the
removal of the implicit guarantee offered by financial institutions on wealth management
products (WMPs). Will it trigger a major decline in WMPs, which in turn would lead to a
credit squeeze on some borrowers, or on the bond/stock market? The slowdown of
infrastructure investment is key in controlling the growth of public debt: the key is whether
the pace of slowdown would be gradual or drastic. For the property sector, the tight
administrative control policies have created a lot of distortions in the market—how they
exit could be a factor affecting market stability.
Modest economic deceleration
We expect real GDP growth to slow down from 6.8% in 2017 to 6.5% in 2018, PPI will
drop to around 3% and CPI may pick up to 2.5%. Export growth will likely slow down to
~4% in USD terms, given the high base and the lack of further depreciation effect.
Infrastructure investment growth will slow down to ~14% in 2018, from ~17% in 2017,
mainly due to the tightening of local government borrowing. Consumption and industrial
investment growth would be stable. Property investment growth could pick up due to
strong land sales in 2017, which were up 13% YTD.
Micro dominates when macro fades
Earnings growth momentum in 2018 will slow down along with nominal GDP growth, in our
view. We expect MSCI China earnings growth to decelerate from 22% in 2017 to 15% in
2018, and the room to beat earnings forecast will get smaller. The US market correction
could be another risk factor, particularly the IT stocks and US-listed China ADRs, which
have a very strong correlation with the US market. With the establishment of Shanghai-HK
and Shenzhen-HK Connect, “southbound” flow from Mainland already accounted for over
6% of HK market turnover in 2017, and we expect it to increase further in the years ahead,
which means that the HK market performance would be increasingly driven by the
interaction of both the US market performance (influencing global liquidity) and A-share
market performance (influencing Mainland liquidity). We are relatively sanguine about the
A-share market in 2018; if the A-share market holds up well, it will provide support to the
HK market through southbound flows.
Our index targets for MSCI China, HSI and HSCEI are 85, 28,000 and 13,000 for the next
12 months. This implies a flat market for MSCI China and HSI in 2018, while HSCEI still
offers around 13% upside. In the CS China Model Portfolio, the biggest OVERWEIGHT is
banks, and the biggest UNDERWEIGHTs are IT and consumer discretionary. Since 2008,
the CS China model has outperformed MSCI China by 59.5%. In 2016, the
outperformance was 5.0%, and the model has outperformed MSCI China again by 6.0%
YTD. The CS China/HK model portfolio has outperformed HSI by 21.0% since December
2013. Our top three picks for 2018 are BOC, Ping An and COLI.