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.