HSBC Global Asset Management

Chinese equity market outlook – Sniffing out investment opportunities in the Year of the Pig

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After a tough 2018, what is your outlook for Chinese equities in the Year of the Pig?

For the 1st half of this year, we expect for certain sectors there will be earnings downward revisions and economic growth will continue to deteriorate. However, we expect the central government, or the local government will respond very quickly in order to boost infrastructure investment, loosening the property sector and stimulate the demand on auto and home appliances. As a result of that, that will stabilize the outlook in Chinese equities. For 2018, we see the multiple contracted by double-digit in the market, we don't expect further multiple derating in the market, however, we expect there will be certain earnings downward revisions in selective sectors going forward.

Domestic demand has been weakening in recent months. Has it changed your long-term view on China's domestic consumption story?

So basically, if you look at consumer demand, we look at different sectors, one is on the auto sector, and the other one is on the property sector, and finally will be on the food and beverage sector, which consists of more commoditized products. The property sector has weakened in the 2nd half of last year, that will trigger a slowdown into auto and home appliance spending as well. But we still see very resilient growth on the food and beverage sector. The government already cut the salary tax last year of 2018, that will boost the disposable income by about single-digit, with stimulus on the auto sector and home appliances and the encouragement on urbanization, we think the consumer sector will do better than the 2nd half of last year.

Some investors have been downbeat on the property sector in recent months. What's your take on the sector?

We think the property sector now is much better than 2015 because of inventory level on the 3rd and 4th tier cities which in 2015 was around 35 months, based on 3-year levels. So right now, if you look at the inventory situation, it's much better than before. Right now, is on average around 8-12 months, which is a normal inventory cycle. And the earnings of the listed property companies, 80%-90% of that has been locked in. So, the earnings visibility is better, and we expect after the working committee in December, we expect there will be much more loosening, from the local government level in terms of the financing, the down payment or the lowering of the interest rate. So, we expect the property sector will continue to be quite stable especially on the 1st and 2nd tier cities.

What are the key risks to investing in Chinese equities this year?

We expect there will be earnings downgrade in certain sectors. We expect the property investment will slow down because the transactions in the 3rd and 4th tier cities if they slow down, that will affect property investment and also the commodity demand. And finally, we expect there could be some defaults, certain type of defaults in the bond market, from local government that may trigger some volatility in the market as well.

On the flip side, what are the positive catalysts for the market?

We are positive on the market because valuation is trading at a 10-year record low level. We also expect the stimulus or the responses from both the central and local government will be much faster and bigger than what the market is expecting. And finally, we expect the manufacturing sector, especially on the confidence side, if the trade disputes are resolved, they will improve quite substantially.