China / Hong Kong Market Focus

Monthly Market Pulse

DBS Group Research . Equity 2 Nov 2022

Volatility to stay until better policy clarity

- **Hong Kong stock market had its worst month since Global Financial Crisis with HSI plunging 14.7% in October**
- **Stock market still facing heightened risks in growth, policies, earnings and geopolitics**
- **Our analysts compiled a list of potential policy catalysts that could restore market confidence, in which easing COVID controls remains the key**
- **We adjusted sector preference to reflect our defensive view, but still favor sectors that benefit from China's long-term development strategies**

A brutal October. Hong Kong stocks finished its worst month since October 2008. The Hang Seng Index tumbled 14.7%, bringing YTD loss to 37.2% and making it the worst-performing stock market in the world. Internet stocks bore the brunt, with the Hang Seng Tech Index sinking 17.3%. Offshore yuan slumped 2.5%.

Market may stay volatile. We think the market may stay volatile in the next few weeks, given 1) the challenging macroeconomic outlook in 4Q and lack of meaningful policy supports in the near term; 2) continued earnings downgrades; 3) weak investors' appetite, especially in terms of foreign funds; 4) aggressive tightening cycle in the US and Europe; and 5) continued geopolitical tensions.

What needs to go right? Clarity on future policy direction is the key. We surveyed our analysts and compiled a list of potential policy catalysts that could restore investors' confidence in their covered sectors. The result shows that a relaxation of the Zero-COVID strategy remains the most critical factor for the market to regain resilience.

Be defensive. We adjusted our sector preference to reflect a more defensive view on the near-term outlook. We think China/HK telcos offer stable earnings and attractive dividend yields. We also turned more positive on the telco equipment and tech hardware sectors as some companies could play critical roles in China's push to develop technology and ensure supply chain security in the long run.

HSI: 14,687

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Recommendation & valuation

Company Name	Code	Closing price (HK$)	Tgt Price (HK$)	FY23F PBV (x)	FY23F PER (x)	FY23F yield (%)
Bank of China HK	2388 HK	24.40	34.1	0.8	7.3	5.5
Budweiser APAC	1876 HK	16.52	31.6	2.2	22.0	1.6
BYD Company	1211 HK	175.70	380.0	3.9	33.0	0.3
China Longyuan	916 HK	8.97	16.6	0.9	9.6	2.1
China Mengniu	2319 HK	25.15	48.2	2.0	14.2	1.8
China Mobile	941 HK	47.25	74.0	0.7	6.8	10.3
CNOOC	883 HK	9.36	16.0	0.6	3.3	12.1
Meituan Dianping	3690 HK	124.80	296.0	4.6	63.9	0.0
Samsonite Int'l ^^	1910 HK	16.88	22.1	3.2	11.4	2.6
SMIC	981 HK	16.40	21.5	0.7	7.3	0.0

Source: Thomson Reuters, DBS Bank (Hong Kong) Limited ("DBS HK"), Bloomberg Finance L.P.

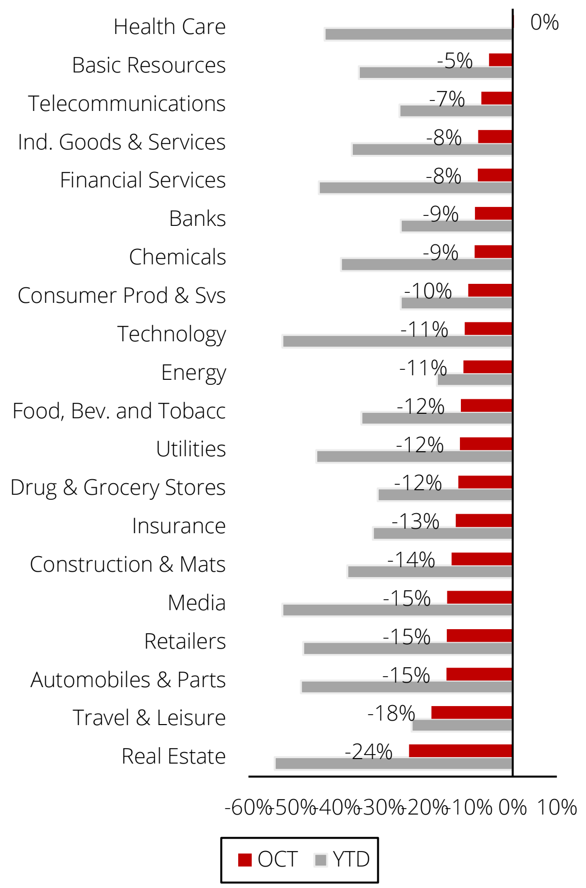
Closing price as at 31 Oct 2022

The worst month since 2008

It was a brutal month. Hong Kong stocks finished its worst October since 2008. The Hang Seng Index tumbled 14.7%, bringing YTD loss to 37.2% and making the city the worst stock market in the world. Internet stocks bore the brunt, with the Hang Seng Tech Index sinking 17.3%. Offshore yuan slumped 2.5%.

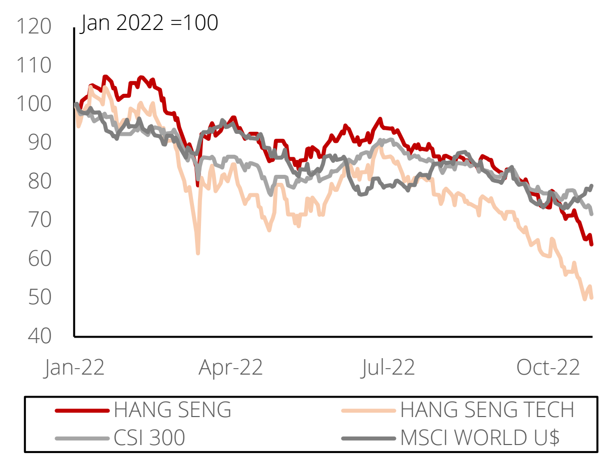
The selloff came amid heightened worries over China's growth outlook and aggressive US rate hike cycle. The 20th National Congress of China's Communist Party, where President Xi Jinping consolidated his leadership, disappointed some investors who hoped for the relaxation of COVID controls and concrete moves to stimulate the economy.

HSCI sector performance in October



Source: Thomson Reuters, DBS HK

Hang Seng Index underperformed in October



Source: Thomson Reuters, DBS HK

Market volatility may continue

We think the market may continue to be volatile in the next few weeks, given 1) challenging macroeconomic outlook in 4Q and lack of meaningful policy supports in China before Central Economic Work Conference in December; 2) continued earnings downgrade; 3) weak investor appetites, especially in terms of foreign funds; 4) aggressive tightening cycle in the US and Europe; as well as 5) heightened geopolitical tensions globally.

1) Challenging economic outlook in 4Q

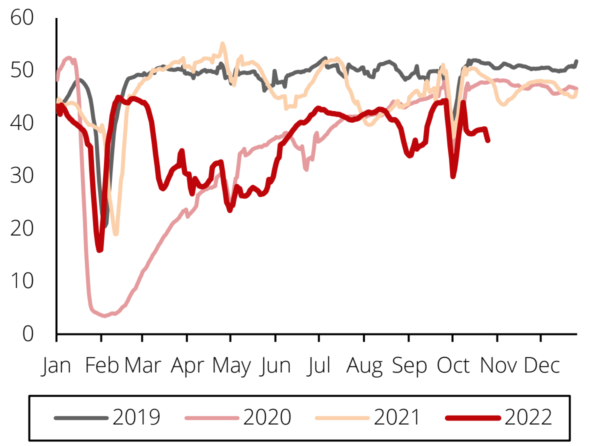
China reported better-than-expected 3Q GDP growth of 3.9%, mainly supported by resilient FAI. However, other growth engines like consumption remain faltering. Our economist team has cut China 2022/23 GDP growth forecast last month to 3.0%/4.0% from 3.5%/5.0%, respectively.

The economy is facing stronger headwinds in 4Q amid COVID resurgence and lockdowns. The Oct official manufacturing PMI unexpectedly contracted to 49.2, slowing from 50.1 in Sep. Non-manufacturing PMI also slid to 48.7 vs 50.6 in Sep. High frequency data in October also pointed to weaker business activities.

Sluggish consumption. Retail sales in September slowed to 2.5% y-o-y, the least in four months and missing the consensus estimate of 3.3%.

Various high frequency data in Oct suggested decline in consumer activities. For example, average daily subway passengers in China's 10 biggest cities dropped 19% y-o-y in Oct amid strict Covid-19 control measures. The number of domestic flights also declined from last month.

Total subway passengers in top 10 cities (mn passengers; 7-DMA)



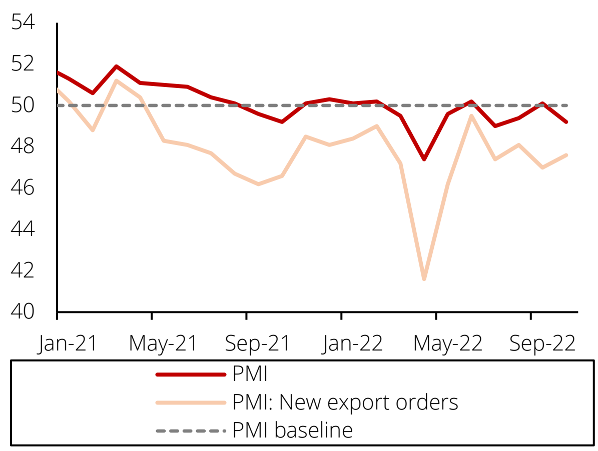
Source: WIND

Auto sales, a major pillar of China's retail sales growth this year, showed early signs of cooling off. China Passenger Car Association [expects]() retail sales volume of passenger vehicles to drop 0.7% m-o-m to 1.91 mn units in Oct, in which NEV sales is estimated to retreat 10% m-o-m to 550,000 units.

Export is also under pressure amid softening global demand. Sep export growth slowed to 5.7% y-o-y vs. 7.1% in Aug. Import growth was at a mere 0.3% y-o-y, suggesting weak domestic demand.

Among key components of the Oct PMI data, new export order was at 47.6 in October, slightly improving from 47.0 in September but still in contraction.

PMI & PMI new export orders

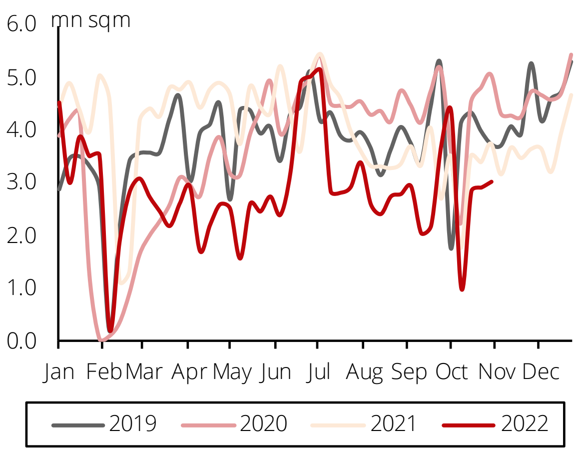


Source: WIND

Property market showed modest recovery but still in y-o-y decline. While national residential sales in Sep posted a 31% m-o-m increase upon a combined pickup in project launches and moderate improvement in sell-through rates, it was still 15.3% lower than the same period last year (vs. -20.8% in Aug).

Looking at high frequency data, the weekly sales in the 30 biggest cities continued to improve, but the pace has slowed.

Property sales in 30 large cities



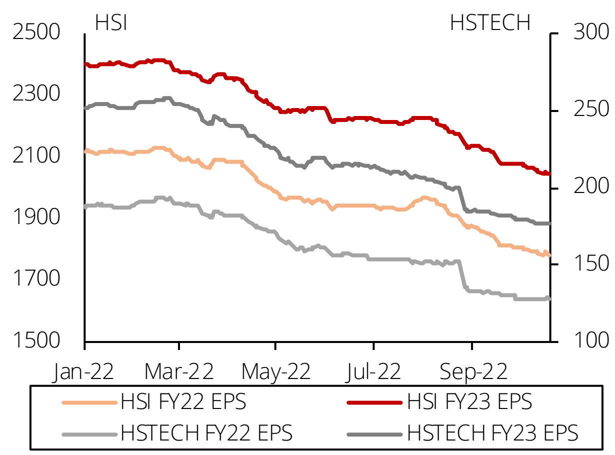
Source: WIND

2) Earnings at risk

The slowing economic growth has led to pressure mounting on corporate earnings. HSI consensus EPS for FY22 has been revised down 16.3% YTD, deteriorating from 14.9% in Jan-Sep. HSTECH's EPS consensus was down 31.5% this year through October.

Currently, the market still expects the HSI to register 14.7% earnings growth in 2023. We think this number is too optimistic due to challenging economic conditions and expect more earnings downgrades after 3Q result season.

Consensus earnings estimate for HSI & HSTECH

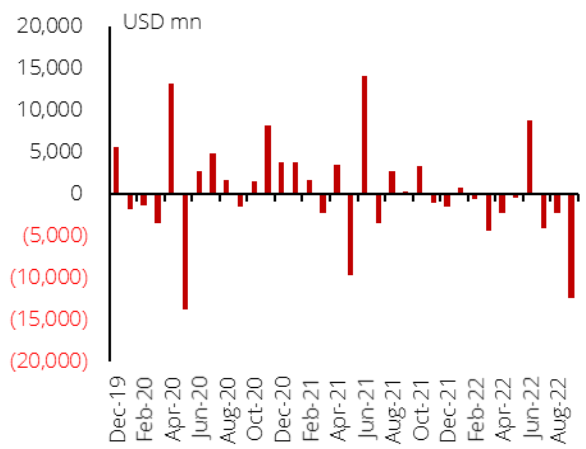


Source: Thomson Reuters

3) Depressed risk appetite

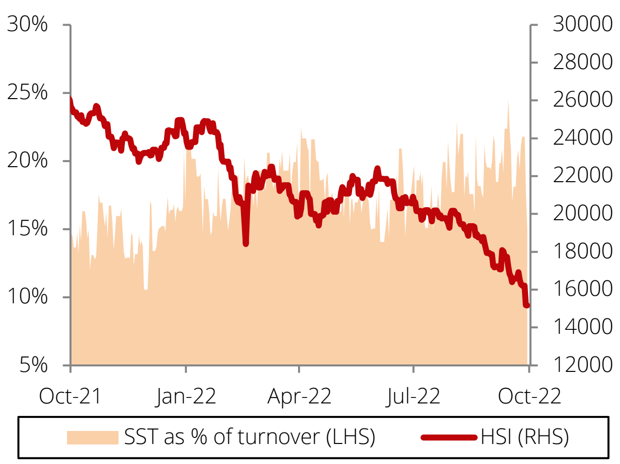
China and HK-focused ETFs saw an outflow of HK$12 bn in September, the worst since the COVID outbreak in 2020. HK market's short-selling turnover as a percent of total market turnover also spiked to a record of 24.5% in Oct and stay elevated at 19.7% at end October.

Fund flows of China & HK-focused ETFs



Source: Thomson Reuters, DBS HK

Short selling turnover as a % of total

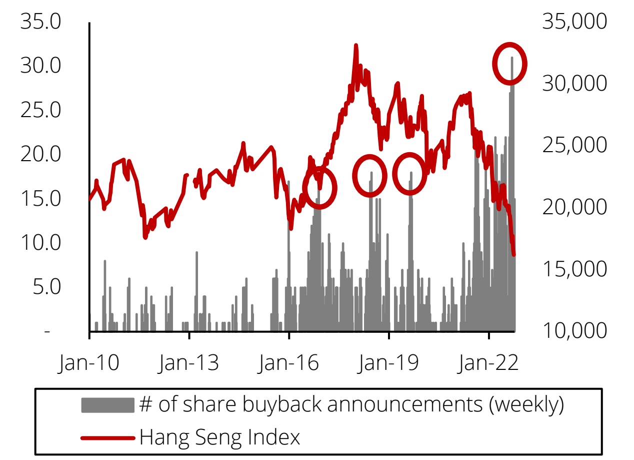


Source: Bloomberg Finance LP

We believe the risk appetite will stay weak until there is better visibility on China's policy direction.

That said, corporates responded to the recent selloff with more buybacks, which may lend some support to stabilise the market.

Buyback activities stay elevated in October

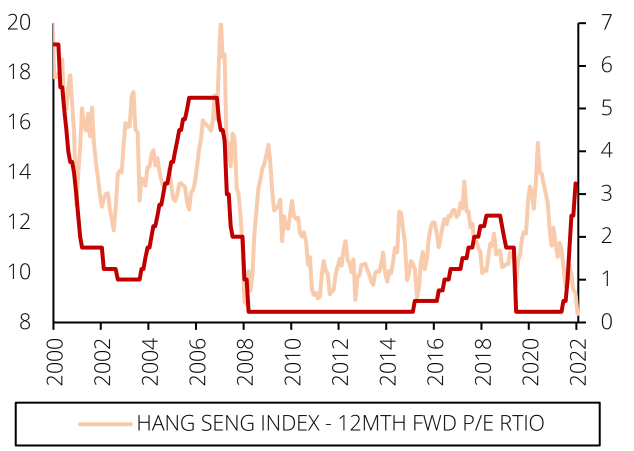


Source: Bloomberg Finance LP

4) US rate hikes

We discussed in September's note (link) that the 12-month forward PE of HSI demonstrates a negative correlation with the US Fed Funds Rate. As showed in the below chart, the PE multiple tends to bottom only when the Fed fund rate peaks, as per the past two rate hike cycles, so we think the rate hikes in global DMs will continue to weigh on HK stocks' valuations.

HSI 12m forward PE vs. US Fed Funds Rate



Source: Thomson Reuters

5) Global geopolitical concerns

Last but not least, the geopolitical tensions will continue to be an overhang, as the US is approaching its midterm election. In October, the US stepped up efforts to curb China's technology development with moves including 1) imposing export controls on chips and 2) banning US talent from working for Chinese chip firms.

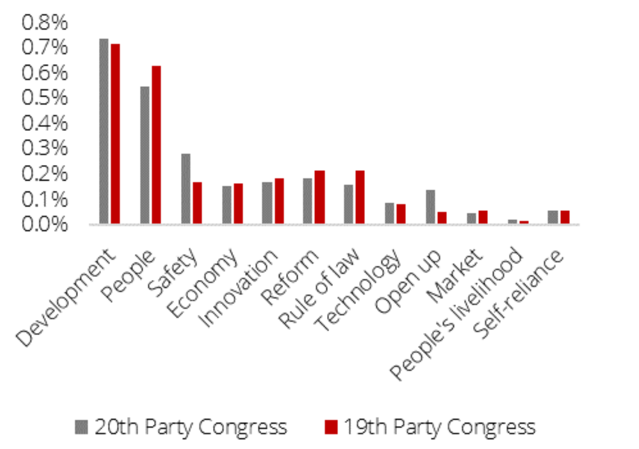
Looking into the new month, any development from PCAOB's inspection on audit working papers of US-listed Chinese firms warrants attention.

What needs to go right to restore market confidence

Better clarity that China's top leaders are still committed to long-term economic growth would be crucial for investors to regain confidence, in our view.

In the 20th Party Congress, President Xi Jinping pledged to grow China into a "medium-level developed country" by 2035, which our economists reckon would require 4.5% to 5% annual growth for the next decade and a half. If this is what the party tries to achieve, the policy makers may need to adopt a proactive stance in supporting the economy in the coming years. Any evidence or sign from this front would be welcomed by market.

Key word frequency of Party Congress' work report



Source: Xinhua, DBS HK

We also expect China's policymakers to shift their focus to review and tackle near-term economic issues, after the party leadership reshuffle settled. COVID control strategy and property measures are two essential areas that need to be reassessed, in our view.

The Central Economic Work Conference in December will provide a window to look for clues of China's policy direction in both near term and long term.

All eyes on COVID control

Should any positive surprise emerge from the policy front, we think the market will react positively given current depressed valuation.

As such, our sector analysts compiled a list of potential measures that could boost the sentiment in their industries, as well as a list of beneficiaries if these catalysts materialize. Our survey showed that a relaxation of the Zero-COVID strategy will significantly boost confidence in sectors ranging from retailing to banks.

Potential policy catalysts if policy makers shift focus back on stabilizing growth

Sector	Potential policy catalyst	Stock picks if the catalyst materializes
Apparel and footwear	Remove COVID-related policies	Anta (2020 HK), Li Ning (2331 HK)
Aviation	Clearer roadmap to China reopening	Air China (753 HK)
China banks	• Further support in ensuring property project delivery and stabilizing real estate sector • Stabilizing monetary policy • Remove COVID -related policies	PSBC (1658 HK)
China brokers	Launch of registration-based IPO system in main board	CICC (3908 HK), CITIC (6030 HK)
China insurers	Border reopens soon	AIA (1299 HK)
China materials	Further supports to property industry	Anhui Conch (914 HK)
China property & China property management	• Relaxation of presales escrow account control • direct liquidity support to distressed and troubled developers • concrete, solid and supportive economic stimulus • remove COVID -related policies	Country Garden (2007 HK), KE Holding (2423 HK), Country Garden Services (6098 HK)
China telco equipment	Any policy that benefits to China telecom carriers will indirectly help on this sector (e.g. better performance of the operators, more capital expenditure on equipment)	ZTE (763 HK) YOFC (6869 HK)
China telecom carriers	Removal of the "acceleration of price reduction" policy, which will help on overall ARPU	China Mobile (941 HK)
Consumer - retailing	China-HK border reopening	Samsonite (1910 HK), Chow Tai Fook (1929 HK), Luk Fook (590 HK), Sa Sa (178 HK)
Environmental service	Remove COVID -related policies	China Everbright Water (1857HK)
Food and beverages	Remove COVID -related policies	Budweiser (1876 HK), CR Beer (291 HK), China Mengniu (2319 HK)
Gas utilities	Remove COVID -related policies	ENN (2688 HK)
HK banks	• Border reopening with mainland China • Further stabilizing policy to support China property sector	BOCHK (2388 HK)
HK developers	• Relax cooling measures for housing market • Full border reopening, especially with Mainland China	SHKP (16 HK)
HK Landlords & REITs	Full border reopening, especially with Mainland China	Wharf REIC (1997 HK)
HK telecom	• Further easing on traveling restriction, such as reopening border with Mainland, will further accelerate roaming recovery	SmarTone (315 HK)

Source: DBS HK

Potential policy catalysts (Continued)

Sector	Potential policy catalyst	Stock picks if the catalyst materializes
Internet	• More detailed explanation on common prosperity and wealth redistribution norms • Any supportive gestures on the platform economy from policymakers • Clearer roadmap to China reopening	Meituan (3690 HK), Pinduoduo (PDD US), Tongcheng Travel (780 HK)
Macau gaming	Remove of COVID-related policies	Galaxy (27 HK), SJM (880 HK), Sands China (1928 HK)
Pharmaceutical and healthcare	• Stop price cut for innovative drugs (class 1) and innovative medical devices • Govt increases subsidy for some products to ease people's financial burden	CSPC (1093 HK), Microport (853 HK)
Renewable energy	• Ease COVID control • Clear roadmap to solve the unpaid renewable subsidies	China Longyuan Power (916 HK)
Restaurants and catering	Remove COVID-related policies	Jiumaojiu (9922 HK), Haidilao (6862 HK)
Tech hardware	US removes chips export curbs	SMIC (981 HK)

Source: DBS HK

Recent policy development

Date	Focus	Department	Measures
26-Oct	Overall economy	State Council	• Reiterates the urgency to boost consumption and investment • Accelerates lending to support equipment upgrades • Expands special relending program to provide loans to SMEs and those upgrading equipment related to consumption
26-Oct	Property	PBOC	Deputy governor Pan Gongsheng asked China Bond Insurance Co to step up support for bond sales by private property developers
26-Oct	Cross-border travel	CAAC	Arranges 840 international flights every week in winter and spring, up 105.9% YoY
25-Oct	Capital market, property	PBOC, SAFE	Pledges to strengthen cross-departments cooperation to ensure healthy developments of equity, bond and property market
25-Oct	Job market	State Council	Publishes measures to promote development of self-employed businesses
21-Oct	Capital market	Stock exchanges	Boosts no. of stocks eligible for margin financing and stock lending
20-Oct	Capital market	China Securities Finance Corp	Lowers margin financing rates by 40 bps
20-Oct	Property	CSRC	Allows certain firms with property business contributing no more than 10% of profit to raise money in A share mkt
14-Oct	Capital market	CSRC	Eases rules to facilitate more company buybacks and mgmt stake increases
13-Oct	COVID control	NHC	Top expert Liang Wannian implies no timeline for reopening in an interview with CCTV
11-Oct	Rmb	PBOC	Pledges to deepen market-oriented reform in FX mkt

Source: Xinhua, government websites, CCTV, DBS HK

Stay defensive & stick to policy beneficiaries

Positive. We adjust our sector preference to reflect a more defensive view on the near-term market outlook. We think China/HK telcos offer stable earnings and attractive dividend yields, amid a misty outlook in HK moving forward. We have also turned positive on the telco equipment and tech hardware sectors as the two also fit the story of 5G infrastructure and domestic chip supply.

Neutral. We think the COVID policy continues to impact the food & beverage and restaurant sectors. We have downgraded the two to neutral. We have also downgraded internet, given its high-beta nature and potential risks from ADRs delisting. However, within the internet subsectors, we like the food delivery business, as the major players are safe from US delisting concerns and have relatively stable business in a slowing economy.

Negative. We have downgraded the apparel & footwear sector to negative, as we expect margin pressure to increase, as most domestic brands will engage in discounting to fend of competition from international brands. China property and China property management were also downgraded, as we believe homebuyer sentiment remains weak, with little signs of improvement in refinancing channels. We have also downgraded China brokers due to sluggish capital market activity data and the YTD retreat in China's A-share index. At last, we have revised down our view on landlords and REITs, in view of the high interest rate environment.

We keep our view on the US Fed Fund Rate hikes, negative wealth effect, and China's slower economic growth to impact the PE valuation investors are seeking.
We maintain our 12mth HSI target at 20,800, which is set at 10.0x FY22F, equivalent to -1.5SD of its 5-year average 1-year forward PE

Please see more in our sector view appendix on page 13.

Changes in sector preferences

Sector	Status
Positive	
China automobile	
China telco equipment	Upgrade
China telecom carriers	Upgrade
HK banks	
HK telecom	Upgrade
Oil and gas	
Renewable energy	
Tech hardware	Upgrade
Neutral	
China banks	
China materials	
China insurers	Downgrade
Consumer – retailing	
Environmental service	
Food and beverages	Downgrade
Gas utilities	
HK developers	
Internet	Downgrade
Restaurants and catering	Downgrade
Negative	
Aviation	
Apparel & footwear	Downgrade
China brokers	Downgrade
China property	Downgrade
China property management	Downgrade
HK landlords & REITs	Downgrade
Macau gaming	
Pharmaceutical and healthcare	

Source: DBS HK

Changes in top picks

We have made four adjustments in our top picks list.

(1) We removed HKEx (388 HK) amid weak market sentiment in the HK market. We added Samsonite for the rebound in international travel with secular growth recovery post COVID-19.

(2) We removed Tencent (700 HK), given the stock is highly correlated to the performance of the HSI during volatile times. We added SMIC (981 HK) to our top picks, as the stock is to benefit from higher domestic demand on the trend of chip localisation.

(3) We downgraded our preference on insurance and upgraded China telcos amid the misty global economic outlook. We replaced AIA (1299 HK) with China Mobile (941 HK) for its stable earnings and dividend payout.

(4) At last, we lowered our auto sector exposure to better diversify our list by removing Geely (175 HK) from our top picks. We added China Mengniu (2319 HK) for its resilient earnings and stable outlook in the dairy sector.

China/HK top picks

Company Name	Code	Closing price (HK$)	Tgt Price (HK$)	Upside (%)	Mkt Cap US$m	PE 22F (x)	PE 23F (x)	EPS 22F (HK$)	EPS 23F (HK$)	ROE 22F (%)	PBV 22F (X)	yield 22F (%)	Net Gear (%)	EPS CAGR 21-23 (%)
Bank of China HK	2388 HK	24.40	34.10	39.8	33,074	9.4	7.3	2.6	3.3	9.0	0.8	5.5	Cash	23.8
Budweiser Brewing Compa	1876 HK	16.52	31.63	91.5	28,049	26.7	22.0	0.6	0.7	9.2	2.4	1.3	Cash	15.3
BYD Company	1211 HK	175.70	380.00	116.3	65,575	51.5	33.0	3.4	5.3	8.8	4.4	0.2	Cash	110.3
China Longyuan Power	916 HK	8.97	16.60	85.1	9,639	11.1	9.6	0.8	0.9	9.2	1.0	1.8	125.4	6.3
China Mengniu	2319 HK	25.15	48.20	91.7	12,753	14.6	14.2	1.7	1.8	15.8	2.2	1.8	42.4	12.7
China Mobile	941 HK	47.25	74.00	56.6	129,409	7.2	6.8	6.6	7.0	10.2	0.7	9.1	Cash	6.4
CNOOC	883 HK	9.36	16.00	70.9	57,111	3.0	3.3	3.2	2.8	24.9	0.7	13.5	10.1	29.0
Meituan Dianping	3690 HK	124.80	296.00	137.2	99,022	n.a.	63.9	-0.3	2.0	-1.3	5.2	0.0	Cash	n.a.
Samsonite Int'l ^^	1910 HK	16.88	22.11	31.0	3,112	22.2	11.4	0.8	1.5	18.9	3.9	1.4	200.9	295.9
SMIC	981 HK	16.40	21.50	31.1	16,655	7.5	7.3	2.2	2.2	12.0	0.8	0.0	Cash	15.6

Source: Thomson Reuters

Closing price as at 31 Oct 2022

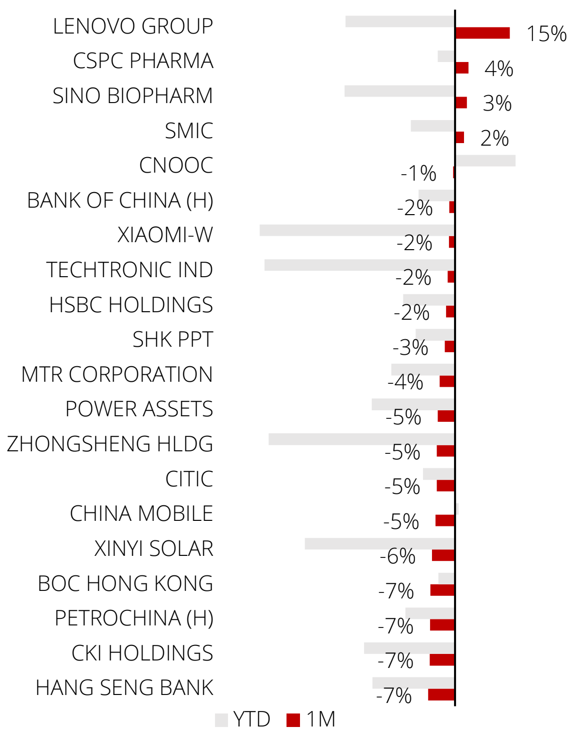
HSI constituents' performance

Hang Seng Index dropped 14.7% in October. Alibaba, Tencent, Meituan and Xiaomi dropped 21.2%, 22.8%, 24.6% and -1.7% respectively. Overall healthcare and tech hardware sector outperformed during period, while China property and internet constituents were the underperformers.

The best performer was Lenovo (992 HK). The stock recorded 7 days increase in Southbound holding. Prior to this, Lenovo announced the first self-developed self-driving edge computing product.

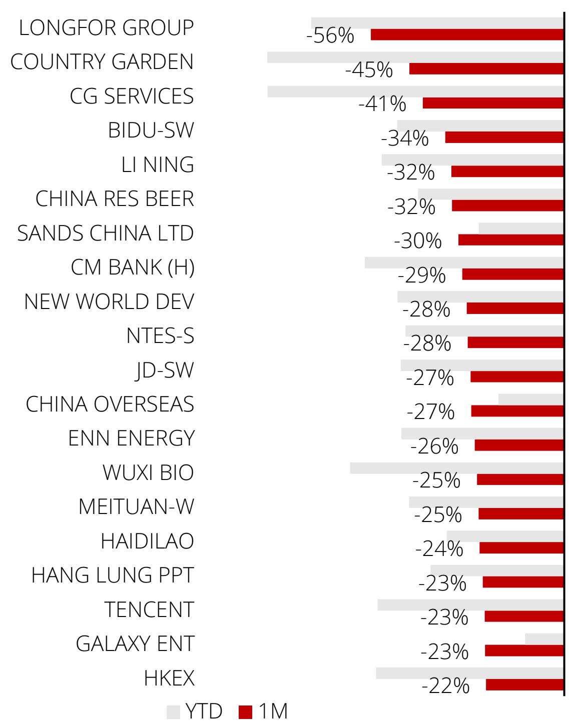
On the flip side, Longfor was the worst performed index stock, as the stock plunged 24% after the resignation of founder Wu Yajun.

Top 20 HSI constituents' performance



Source: Thomson Reuters

Bottom 20 HSI constituents' performance



Source: Thomson Reuters

Live more, Bank less

Changes in sector preferences and top picks

Sector	Status	Top picks	Changes
Positive			
China automobile		BYD (1211 HK), Geely (175 HK)	
China telco equipment	Upgrade	ZTE (763 HK)	
China telecom carriers	Upgrade	China Mobile (941 HK)	
HK banks		BOCHK (2388 HK)	
HK telecom	Upgrade	SmarTone (315 HK)	
Oil and gas		CNOOC (883 HK), Petrochina (857 HK)	
Renewable energy		China Longyuan Power (916 HK)	
Tech hardware	Upgrade	Hua Hong (1347 HK), SMIC (981 HK)	Added Hua Hong
Neutral			
China banks		PSBC (1658 HK), BOC (3988 HK)	
China materials		CHALCO (2600 HK)	Removed Ganfeng (1772 HK) Tianqi (9696 HK) and added CHALCO
China insurers	Downgrade	Ping An (2318 HK), AIA (1299 HK)	
Consumer – retailing		Samsonite (1910.HK), Prada (1913.HK)	
Environmental service		Canvest (1381 HK)	
Food and beverages	Downgrade	Budweiser (1876 HK), CR Beer (291 HK), China Mengniu (2319 HK), UPC (220 HK)	
Gas utilities		ENN (2688 HK)	
HK developers		SHKP (16 HK), CK Asset (1113 HK), Sino Land (83 HK)	
Internet	Downgrade	Meituan (3690 HK), Pinduoduo (PDD US)	
Restaurants and catering	Downgrade	Yum China (9987 HK)	
Negative			
Aviation		China Southern Airlines (1055 HK)	
Apparel & footwear	Downgrade	ANTA (2020 HK)	
China brokers	Downgrade	CICC (3908 HK), GF (1776 HK)	
China property	Downgrade	COLI (688 HK), CR Land (1109 HK), Yuexiu (123 HK)	Removed Beike (2423 HK)
China property management	Downgrade	CR MixC (1209 HK)	Removed CS Service (6098 HK)
HK landlords & REITs	Downgrade	Link REIT (823 HK) Fortune REIT (778 HK)	
Macau gaming		Galaxy (27 HK)	
Pharmaceutical and healthcare		Shandong Weigao (1066 HK), Shenzhen Hepalink (9989 HK)	Replace CR Medical (1515 HK) with Shandong Weigao , Shenzhen Hepalink

Source: DBS HK

Positive

China automobile

Industry PV sales rose c.33% y-o-y to c.2.3m units, attributable to the Chinese Government's stimulus policies. The sales growth was strong compared to Jul-Aug's 37%-40%. However, growing concerns of global weaknesses, plus challenges in the domestic market such as the property market slump, pandemic lockdowns, and slower GDP growth are all weighing on consumer sentiment. The China Consumer Confidence Index has been below the level of 90 since Apr 22, which could impact the consumption appetite. We anticipate the peak sales season in 4Q (last-minute rush to beat expiry of the PV tax cut benefits) to provide some support to the sector's performance. We estimate 4Q PV sales volume to reach about 6.9m units, +4% after factoring in the high base. The energy crisis in western economies and yuan depreciation could affect the Chinese auto sector, especially in the imports segment. Sedan imports fell c.15% to about 390,000 units in 8M22.

The current global challenges are weighing on auto sector performance, which is trending down along with the HSI. The auto sector share price was down 15%-40% on a one-month horizon to currently trade at 6x-8x prospective PE, or 1 to 2SD below the respective five-year historical mean. We anticipate the auto sector to remain volatile. As electrification remains a relevant theme in the long term, our preferred pick is Geely (175 HK).

Top picks: BYD (1211 HK), Geely (175 HK)

China telecom carriers

The strong revenue growth momentum in 2021 will continue in 2022, attributable to a steady traditional telecom business and robust growth of new business (e.g., cloud, IDC and IOT, etc). Mobile ARPU will continue to recover, driven by higher 5G penetration of 64% in 2022, compared to 44% in 2021. Bandwidth upgrade will help improve broadband ARPU. Besides, China Mobile (CM, 941.HK) announced it plans to gradually increase its dividend payout ratio from 60% in FY21 to 70% by FY24, following China Telecom (CT, 728 HK), which implies an c.8% yield. CM is our top pick for its robust earnings growth and attractive dividend yield of 9% for FY22.

Top pick: China Mobile (941 HK)

China telco equipment

The sector is driven by capital expenditure of Chinese telecom operators. The capex budgets of three domestic operators increased by 4% in FY22 to Rmb353bn. Mobile capex decreased by 7%, while capex for fixed-line network and others increased by 9% and 22%, respectively. The focus of mobile network investment will still be on macro base transceiver station (BTS) build-out, with an estimate of more than 600k net additions for FY22. For fixed-line network and others, the focus will be on transmission network, data centre, and cloud computing, guided by the Eastern Data, Western Computing initiative. In general, as the profitability of operators' 5G business improves on the back of higher penetration, further pricing pressure is limited. Growth for individual players will be driven by higher capex, increase in market share within its addressable market, and margin improvement. Our top pick is ZTE for its increasing market share in carriers' network business.

Top pick: ZTE (763 HK)

HK banks

We expect the current rate cycle to benefit HK banks' NIM and net interest income. We expect NIM to sequentially recover in 2H22. Also, business activities would signal better recovery ahead with the reopening of the Hong Kong economy. With improving investment demand, we expect loans to grow at a mid-single-digit rate in FY22F. Fee income growth faced pressure in 1H22 due to market volatility, but we expect some marginal recovery in 2H22.

On the back of a sufficient capital level and better earnings, we expect HK banks' valuation to re-rate from the current valuation level of below its five-year trading average.

Top pick: BOCHK (2388 HK)

Renewable energy

President Xi Jinping reaffirmed the country's goal for green development in his work report to the 20th Party Congress. Xi proposed to speed up the development of green and low-carbon industries and to promote green and low-carbon production methods and lifestyles. He reiterated China should accelerate the construction of a new energy system and actively participate in the global governance of climate change. However, the mentions of low-carbon development were tempered by an emphasis on energy security, including the use of coal, to avoid disruption. Xi mentioned that China should establish a reliable renewable energy system before cutting the use of fossil fuels. An NEA official elaborated in a later press conference that China will actively promote the use of carbon capture, utilisation, and storage (CCUS) to control the emissions from coal.

China's new wind installations rose 17.1% y-o-y in 9M22, reaching 19.24GW. However, wind turbine ASP remains subdued. In Oct 22, bids were as low as Rmb1,705/kw for onshore turbines (excluding tower), down c.14% YTD. Given lacklustre wind turbine ASP, we maintain HOLD on Goldwind with HK$13 TP. China Longyuan Power (CLYP) continues to perform steadily with 11.8% y-o-y growth in power generation in 9M22, led by wind (+13.6%) and other renewables (+87.2%). CLYP H-shares trade at FY23F PE of 12x, which is below the historical average since Sep 20. We rate CLYP BUY with HK$22 TP.

China's new solar installations rose 105.8% y-o-y in 9M22, reaching 52.6GW. The Chinese Central Government announced it has spoken to major Chinese polysilicon makers and industry associations about high market prices. However, polysilicon prices have held firm at >Rmb300/kg since the discussion in mid-Oct. Against strong new solar installations, wafer maker TCL Zhonghuan (TZE) reported solid 9M22 results with net profit up 81% y-o-y. We rate TZE BUY with Rmb72 TP. Module leader LONGi announced a profit alert indicating c.40%-48% 9M22 net profit growth. We rate LONGi BUY with Rmb91 TP.

Top picks: China Longyuan Power (916 HK), TCL Zhonghuan (002129 CH)

HK telecom

For mobile businesses, the roaming business suffered from city lockdowns amid COVID-19 and represented 4%-8% of mobile revenue in FY21. Roaming revenue has shown a prominent recovery, reaching 30%+ of the pre-COVID-19 level in recent months. We expect further recovery, as the government has eased travel restrictions recently with its 0+3 policy. Despite the intense competition, we expect local service revenue to be solid, driven by higher 5G penetration. For fixed-line businesses, we expect total residential broadband subscribers to grow 2% and 1.5% in 2022 and 2023, respectively. However, heavy competition may post difficulties for ARPU increment in the fixed-line market. In the near term, we prefer mobile operators to fixed-line operators, as the former will benefit from the recovery of mobile roaming business, which commands a high profit margin.

Top pick: SmarTone (315 HK)

Tech hardware

Semiconductor – China semi equipment provider
The lead time for chip delivery further declined from 26.8 weeks in Aug 2022 to 26.3 weeks in Sep 2022. While the overall shortage is further easing, the wait for power management parts and microcontrollers, particularly those used by automakers and industrial equipment manufacturers, remains extended. The bookings guidance of some of the semiconductor equipment providers like ASMPT (522 HK) show signs of further slowing.

Semiconductor – China Foundry
Major foundries in the mainland were mildly impacted by the latest chip export curbs by the US as they focus on mature node foundry (28nm or above) in their business model. Foundries like Hua Hong, which focuses only on mature process nodes and possessed EUV certification from the US Commerce Department, are the least impacted.

In the long run, the US and European CHIPS Act accelerate foundry localisation in the US, Europe, and China. We expect the high utilisation rate to be maintained and ASP hike to continue in most chip types of trailing nodes in 3Q due to the high end-market demand.

We also expect the demand from robust EV growth in China to continue to drive auto chip demand, and for mainland foundries that specialise in mature nodes, like Hua Hong (1347 HK), to benefit.

Hardware vendors
The Rmb depreciation would mostly affect hardware end product vendors or manufacturers like Xiaomi and Lenovo or even China foundries like SMIC, which have a global market or significant portion of overseas sales, e.g., 68% for Lenovo, 50% for Xiaomi, and 36% for SMIC.

As their raw materials are mainly sourced in the mainland, the depreciation of the Rmb is going to increase the competitiveness of its end product overseas. This will boost sales or the profit margin of overseas sales in the long run.

Smartphone value chain
Inflation concerns and weak consumer sentiment continue to drag smartphone shipment growth in 3Q22. The y-o-y decline in smartphone component shipments is expected to be maintained in 2022. However, we see limited room for further shipment downside in 2H compared with 1H due to the launch of flagship models from most smartphone vendors and new demand from new AR/VR products.

Specification downgrades continue to occur in android phones, according to suppliers. We expect demand for smart device components, i.e., lenses, camera modules, acoustic components, and casing, to not show any significant recovery until 2H23. The shipments of optics and acoustics component suppliers like Sunny Optical (2382 HK), AAC Tech (2018 HK), and Q Tech (1478 HK) will share the same growth trend.

iPhone shipments-maintained y-o-y growth in 3Q22. We expected Apple's market share gain to continue in 2022. This favours assemblers like Luxshare (002475 CH), which has higher shipment and product penetration among the beneficiaries of the share gain.

Top pick: SMIC (981 HK), Hua Hong (1347 HK)

Neutral

China banks

Total social financing data in Sep is above market expectations, but mortgage remained weak. The market is still concerned about the uncertainties in the China property sector, economic recovery, and weak demand. Regarding the property sector impact, we 1) expect low to mid-single-digit property-related loan growth in FY23F; 2) see the NPL ratio in mortgage in 2H22 trending similar with that of 1H22, but the FY23F risk might be higher if government support to ensure flat delivery is not as effective as expected; and 3) continue to see NIM pressure with LPR and mortgage rate cuts. We expect the sector to see more upside only after seeing more signals of recovery for China property and the economy, which may likely be in 4Q22 or early 23. In the short term, we expect large SOE banks like the Big Four to be more defensive, as they have higher corporate loan exposure, which is less affected by the lower price in mortgage and as demand is more stable during the economic slowdown. In the long term, we prefer oversold quality names such as PSBC.

Top picks: PSBC (1658 HK), BOC (3988 HK)

China insurers

With consistent improvements in agent productivity, the bottoming of the agent channel VNB decline, strong bancassurance channel performance that will drive new business growth, and a low base, we believe China insurers' VNB will likely resume growth in FY23. Both Ping An and AIA have shown positive signs of growth recovery. Our estimate suggests that China insurers' underwriting book quality has improved further, with estimated cost of liability (COL) reaching 3.4%-4.4% in 1H22, aided by better cost control and better operating experience. We believe investors have overlooked the book quality improvement. Moreover, concerns over the property investment risk are overdone, with exposure stable at 3% to 5.7% of the total portfolio and limited credit incidents. As China insurers' share price has further corrected more than 30% on average since 3Q22, we believe the concerns on a) China property exposure and b) poor investment income resulting from equity market volatility, should be mostly in the price.

Top picks: Ping An (2318 HK), AIA (1299 HK)

China materials

In Jan-Sep 2022, China major industrial material production in terms of cement, crude steel, and aluminium had dropped 12% (narrowed), dropped 3% (narrowed), and increased 2% (unchanged), respectively. On the inventory side, as of late Sep, the cement silo level had slightly lowered after cement producers extended their capacity suspension. Steel inventory was trending down to the mid-level of the historical range, whereas aluminium inventory reported in society stood at the low end of the historical range amid stable smelting capacity utilisation. In anticipating downstream real demand to further pick up, overall market sentiment should gradually improve in the near term.

Top pick: CHALCO (2600 HK)

Environmental service

During the Communist Party Congress, President Xi reiterated China's pursuit of a low-carbon growth society by giving priority to environmental protection and green lifestyle. In particular, implementation focus will be placed on intensifying the prevention of pollution. This will bode well for the high-quality development of the environmental service sector. However, COVID restrictions are expected to negatively impact environmental service companies. First, construction progress will be delayed; hence construction revenue growth will be slower. Second, the amount of waste being collected has declined due to weaker economic activities as well as constraints in the workforce. Third, a longer accounts receivable period from government will have a negative impact on cash flow. In addition, inflation will also increase operating cost. Although environmental projects are allowed to adjust tariffs every two to three years, there is a time lag which will cause short-term pressure on the margin.

Top pick: Canvest (1381 HK)

Consumer – retailing

In 9M22, China retail sales grew by 0.7% y-o-y to RMB32tn. Specifically, the 2.5% growth in September decelerated from August's 5.4% growth, amid the resurgence of new COVID-19 cases and tightened control measures across more cities of China. In Sep 2022, categories for the above-designated-size enterprises (ex-autos) that registered a better performance included traditional Chinese & western medicines (+9.3%); cultural & office appliances (+8.7%); grain, oil, & foodstuff (+8.5%); communication appliances (+5.8%); and beverages (+4.9%). The key discretionary categories saw mixed performance, including gold, silver, & jewellery (+1.9%); garments & footwear (-0.5%); and cosmetics (-3.1%). Major sales declines were seen in tobacco & liquor (-8.8%), building & decoration materials (-8.1%), furniture (-7.3%), and household appliances & AV equipment (-6.1%). Overall catering services saw a 1.7% sales decline in Sep 2022. We believe the sales trend for 4Q22 could remain very moderate amid lingering COVID-19 impacts, and project China retail sales to grow by c.1.5% for the full year of 2022.

Turning to the HK market, retail sales declined by 1.5% y-o-y in 8M22, with a 0.1% decline for the month of August (Jul 2022: +4.1%), as the new round of government consumption vouchers have been split into two parts for August and October, hence leading to less impacts versus the first round of vouchers in Apr 2022. Online sales went up strongly by 21.3% to account for 9% of total sales in Aug 2022. Categories (ex-autos) that outperformed in Aug 2022 included jewellery & watches (+4.3%) and food, alcoholic drinks, & tobacco (+2.1%), while those that declined included books, newspapers, stationery, & gifts (-17.4%); optical shops (-8.7%); furniture & fixtures (-8.5%); clothing & footwear (-8.4%); Chinese drugs & herbs (-3.4%); electrical goods (-3%); and medicines & cosmetics (-0.2%). We expect retail sales in HK to stay flat for the full year of 2022, and it could remain slow in 1H23, as the market is the expecting borders between Mainland China and HK to only reopen in mid-2023, at the earliest.

On the other hand, some renowned global brands could benefit from the revival in travel as more countries open up for visitors, while luxury brands also hold up well in terms of operational performance as high net worth customers continue to be relatively more resilient.

Top picks: Samsonite (1910 HK), Prada (1913 HK)

Food and beverages

September and October saw a tightening of COVID restrictive measures, due to a spike in infection rates, leading to softer-than-expected sales during the National Day Holiday period. Catering channels (e.g., restaurants and bars) for F&B companies could suffer to some extent (Sep 22 China catering revenue down 1.7% y-o-y). The upcoming FIFA World Cup could support better recovery, especially for the brewery sector, should the COVID-19 control measures continue to ease. As we move forward and approach the 2023 New Year and Chinese New Year, the dairy and pork sector could also see stronger market demand.

Overall cost pressure from raw materials softened but remained high y-o-y in 3Q22. Selective commodities like aluminium, barley, and palm oil have peaked in 2Q22, followed by general downward trends, supporting better margin recovery in 2H22. However, price pressure from soybean meal remains high in the near term (up c.17% y-o-y YTD). Normalising the supply of major soft commodities in FY23 could help F&B companies achieve margin recovery. Our key picks include Budweiser, CR Beer, China Mengniu, and UPC.

Top picks: Budweiser (1876 HK), CR Beer (291 HK), China Mengniu (2319 HK), UPC (220 HK

Gas utilities

In 8M2022, the natural gas consumption y-o-y growth rate was flat amid COVID lockdowns in various places in China. On a positive note, Q3 2022 GDP pointed to faster-than-expected growth with stronger growth in industrial production. This should bode well for improving gas consumption in 4Q. Most gas distributors have lowered their gas volume growth expectation for 2022 by at least 5ppt to 5%-8%. Despite the slow gas consumption, gas supply from Russia increased significantly YTD. We expect Russia will become one of China's major gas suppliers, accounting for around 15% of total imported natural gas supply in 2022. Not only will gas supply be more stable and diversified, it is also positive for gas procurement, as Russian gas is more competitively priced.

Amid uncertainty due to the Russia-Ukraine war, the dollar margin pressure from gas distributors in 4Q should be manageable, because 1) high LNG prices have already deterred demand, prompting users to switch to alternatives; 2) a lower percentage of spot LNG transactions and increasing spare capacity in PipeChina's LNG terminals are other signs that LNG prices have peaked; and 3) a contracted volume will be set for residential users to ensure sufficient supply.

Top pick: ENN (2688 HK)

Internet

(1) China's food delivery and e-commerce segments' growths will be back-end-loaded in 2022. In 9M 2022, China online retail sales grew by 6.7% y-o-y, higher than overall retail's 0.7% growth, as the online market gets more market share from offline amid COVID disruptions. Food delivery and e-commerce are the first two segments that displayed a most significant rebound after COVID in 2020. We believe these two sectors could outperform other sub-sectors in 2H to resume 16% and 10% growth, respectively, in 2H22, as they are immediate beneficiaries of consumption recovery. We changed our e-commerce top pick to Pinduoduo, as it delivers stronger revenue growth driven by rising demand for fresh groceries. Online penetration of these essential goods remains low and demand stays resilient amid weak consumption. Moreover, e-commerce players become more rational on investment in new initiatives (e.g., community group buying) amid the challenging macro environment, which is positive to overall profitability in 2H22.

(2) Online game growth is expected to remain weak the rest of the year, due to few new blockbusters games and weaker consumption. The resumption of game license approval will support the game pipeline in 1H23. Tencent and NetEase finally received new game licenses in the recent batch in Sep. Chinese domestic mobile game revenue further decreased by 25% y-o-y in 3Q22 due to the lack of new games and slower user growth, according to CNG. Game developers will focus on overseas expansion.

(3) Online advertising is one of the key revenue contributors to internet companies. The segment's growth will remain challenging in 4Q22, partly due to the economic slowdown and regulatory changes. Performance has been dragged by the weakness in certain verticals, such as education, online games, and insurance.

(4) Online travel suffered from city lockdowns in the past two years. Domestic short-haul trips have been gaining importance and supporting recovery. The short-term outlook remains cloudy, given the sharp decline in tourist numbers and tourism revenue during the Golden Week holiday in Oct. Expect domestic travel to continue to see a steady recovery in 4Q22, but we assume that the zero-COVID goal should remain in place this year. Players focusing on domestic travel and expansion in lower tier cities have a higher potential to outperform.

Top picks: Meituan (3690 HK), Pinduoduo (PDD US)

HK developers

The HIBOR hike since mid-22 has dampened residential demand, which resulted in overall home prices falling >8% YTD. Rising mortgage rates should continue to cloud residential market sentiment. Coupled with the negative wealth effect from the financial market correction, we forecast home prices to fall by another 5% over the next 12 months. In the event of a sharp price correction, we do not rule out the possibility of the government relaxing some of the cooling measures to stabilise the market. The long-awaited reopening of the border with Mainland China, if materialised, could boost luxury demand with the return of affluent mainland buyers.

We like SHKP for its attractive valuations. The stock remains a core holding among those betting on the Hong Kong property market, which could re-rate if the government further relaxes border control measures. We also like Cheung Kong Asset Holdings. which is well poised to make value-accretive acquisitions to bolster long-term growth with a strong balance sheet. Continued share buybacks should provide solid support to its share price. Sino Land is a prime beneficiary of the interest rate upcycle with a strong net cash holding.

Top picks: SHKP (16 HK), Cheung Kong Asset Holdings (1113 HK), Sino Land (83 HK)

Restaurants and catering

Industry catering sales recorded a gradual recovery from severe lockdowns in mid-March-May (Source: NBS). June/July/August reported catering sales changes of -4%/ +1.5%/+8.4% y-o-y, versus a sales decline of 21.1% in May. However, September and October saw a tightening of COVID restrictive measures, due to a spike in infection rates, leading to softer-than-expected sales during the National Day Holiday period. According to the Ministry of Culture and Tourism, domestic tourist revenue declined 26% y-o-y and was equivalent to 44% of 2019 revenue. The number of trips made to domestic destinations also declined by 18% and was equivalent to 61% of 2019's total number of trips. Short-distance trips were favoured due to control policies. The current COVID situation remains sporadic and restauranteurs are finding it difficult to operate. Consumer appetite is also affected by a slowdown in the macroeconomy. We prefer the fast-food category, with companies such as Yum China (9987.HK), as it derives a higher percentage of revenue from takeout and deliveries, which is fast becoming a norm in food consumption, accelerated by COVID policies.

Top pick: Yum China (9987 HK)

Negative

China brokers

The China brokerage sector's share price on average was down 41% YTD. We believe the recent share price weakness was due to 1) a YTD retreat in China's A-share index, 2) the market's downward revision in its earnings forecast, 3) sluggish capital market activity data, and 4) concerns over further margin contraction.

YTD ADT and average margin balance were -6% and -7% y-o-y, respectively. Given the latest A-share index was c.25% lower than the 4Q21 average level, we expect the y-o-y gap in ADT and margin balance to slightly widen by the end of FY22. Nonetheless, we think the earnings impact to brokers would be partially offset by the (1) resilient onshore equity financing volume (YTD +5% y-o-y) and (2) recent downward revision of margin refinancing interest rate.

Our long-term positive outlook on brokers remains intact. The positive policy cycle should continue to be favourable, and we expect the long-awaited registration-based IPO reform to be implemented across all boards within the next few months, which will serve as a strong driver for the sector. The growing institutionalisation also helps to enhance brokers' ROE in the long term. With the sector trading at 0.5x PB, which is the lowest over the past five-year trading band, the risk-reward is hereby considered attractive.

We continue to like brokers with a strong investment banking and asset management franchise. CICC and GF remain our top picks in this space.

Top picks: CICC (3908 HK), GF (1776 HK)

Aviation

1H22 results were notably worse than our expectations. Net losses during the period were equivalent to three-four years of their respective net earnings prior to the pandemic and more than double the net losses incurred in 1H21. Domestic air travel activity was severely depressed (below 30% of pre-pandemic levels) between March to May 22, as multiple cities, including key hubs like Shanghai and Beijing, were thrown into partial or complete lockdown to curb the spread of the Omicron variant. While domestic air traffic rapidly regained lost ground to 65%-70% of pre-pandemic levels in July 22, the recovery remains fragile, as snap lockdowns continue to be the tool of choice to suppress new cases, while the recent 20th Communist Party Congress provided zero clues on China's strategy to exit zero-COVID.

We now expect the three Chinese airlines to report wider net losses in FY22F and remain in the red in FY23F, as we lower our air traffic assumptions. Our current earnings estimates are still predicated on China reopening in mid-2023, with international traffic hitting 25%-30% of 2019's level for the full year of FY23F. The street is still overly bullish on the three Chinese airlines, in our view, particularly on the extent of recovery of international air traffic in FY23F. We downgrade our recommendations on CSA to HOLD with a lower TP of HK$4.40 and Air China to FULLY VALUED with a lower TP of HK$4.00. Meanwhile, we are maintaining our HOLD call on CEA with a lower TP of HK$2.50. We believe that the risk-to-reward set up for Air China is highly unfavourable, given the stark divergence in its share price performance and fundamentals. Overall, current valuations for the three Chinese airlines are >2SD above their respective five-year averages, which is expensive, when considering their lacklustre near-term recovery prospects and potential share dilution. Additionally, they are trading at considerably higher multiples than regional airline peers with stronger credit metrics and more promising earnings profile. While the longer-term outlook for the Chinese airlines remains bright, we believe that it is not the right time to accumulate their shares yet.

Aircraft lessors are our preferred pick at this juncture, because of their earnings resilience and attractive valuations. Despite the threat of new COVID-19 variants, BOC Aviation's earnings should continue to grow on the back of sustained portfolio expansion (via both organic and via purchase and leasebacks) and healthier lease rates. Lessors are not directly impacted by buoyant jet fuel prices and could see stronger demand for leased aircraft as airlines dial back on capital spending.

Sanctions on Russia are manageable, given the lessors' limited exposure to the country (BOCA - 3.0% of aircraft net book value, CALC <1.0%), and other buffers in place like insurance on affected aircraft. Outside of Russia, the risk of asset and bad debt impairments is declining, with aircraft values and airlines' financial performance stabilising. Additionally, there are multiple tailwinds which should propel a shift towards leasing over the medium term. Hence, we anticipate a solid upside from here, driven by BOCA's strong earnings momentum, and believe that the current share price is a good entry point, given that the stock is only trading at -1.0SD below its five-year average on a P/BV basis.

Top pick: China Southern Airlines (1055 HK)

Apparel and footwear

Inventory concern has heightened in 3Q22 due to slowdown in the retail environment and COVID-19 lockdowns impacting offline traffic. We expect Double 11 Shopping Festival will be crucial to drive sales to lower inventory levels across the board, through an increase in retail discounting. While domestic brands continue to gain market shares relative to international brands, we expect most will engage in discounting to clear inventory from 4Q22 onwards, which will increase overall sector margin pressure. Our preferred pick is Anta, where it is trading at 20.5x FY23E PE, versus Li Ning at 23x FY23E PE.

Top picks: ANTA (2020 HK)

China property

We remain cautious on the sector's near-term outlook. On one hand, while top leadership in China should now be able to devote more focus towards tackling lingering economic issues upon the conclusion of the 20th National Party Congress, the pace of launching further supportive measures will likely be done in a gradual and controlled manner, the impact of which will take time to filter into the economy and the property sector. As such, we believe homebuyer sentiment will likely remain weak in the near term, with the physical market to record only a mild recovery in 4Q22, driven by an expected pick-up in developers' project launches. On the other, refinancing channels continued to show no signs of improvement, with bond investor sentiment dampened further upon CIFI's non-payment incident. More bond extensions and defaults will likely materialise in 4Q throughout the repayment peak, with surviving POEs and semi-SOE names to continue facing tough repayment pressure.

Investor sentiment remains fragile and share price performance is expected to remain volatile in the near term. A sustainable recovery in share prices is expected to come only when the Rmb stabilises, physical market recovers, and refinancing channels reopen. We recommend investors to stay with quality names that are less impacted by the Rmb depreciation and able to benefit from the potential release of more policy supports – COLI (688 HK), CR Land (1109 HK), and Yuexiu (123 HK).

Top picks: COLI (688 HK), CR Land (1109 HK), Yuexiu (123 HK)

China property management

Property managers have exhibited strong price correlations with their respective related developer names since the start of the property sector turbulence in 2H21. With the dust yet to settle in the property sector, we believe the relationship will continue to hold. We therefore expect share price volatility, particularly from borderline surviving developers, will continue to feed into their respective property managers in the near term. Having said that, we believe the relationship should break as market sentiment calms and focus is redirected onto fundamentals. Afterall, PM names are non-cyclical in nature, and are fundamentally less tied to the property development space than those with a close share price correlation. The 1H22 result would be a clear case in point, where the sector, on average, was able to record double-digit growth under COVID-19 disruptions and the property market downturn, while the development side, in general, recorded deep declines or even losses. We believe PM names are fundamentally better for investors as proxies to ride on the physical market recovery, as it has more resilient and visible earnings vs. that of developers.

Among individual stocks, we recommend staying with quality SOE names for their likely capability to benefit first from a potential physical market recovery and investor sentiment pick-ups with better risk profiles. We have CR MixC (1209 HK) as our sector top pick in this regard.

Top pick: CR MixC (1209 HK)

HK landlords & REITs

Despite the fifth wave of the pandemic, the overall office market in 1H22 registered flattish rental growth with a stabilising vacancy rate. The central market outperformed, as it was driven by demand for the premium office space. Yet, with border restrictions remaining in force, new demand from MNCs and mainland Chinese firms was subdued. Major leasing activities were highlighted by expansionary demand from existing wealth management, flexible space operators, and healthcare occupiers in Hong Kong. New office supply will come on stream starting from 2022. Thus far, pre-leasing progress has been slow. Vacancy is expected to rise again, which should exert downward pressure on office rents.

The Hong Kong retail market was on the road to recovery, aided by the easing of social distancing measures and the distribution of electronic consumption vouchers. The decline in overall retail sales narrowed to 1.5% in 8M22 from 1Q22's 7.6%. Local economic recovery should also underpin domestic consumption. While the government has recently relaxed travel restrictions for incoming visitors, we do not expect a boost to retail sales with the absence of leisure travellers, especially from the mainland. Overall, we estimate total retail sales to be broadly stable for 2022. A full-fledged retail market recovery still hinges on the border reopening with China.

We favour Link REIT and Fortune REIT, which should benefit from gradual domestic consumption recovery. Further yield-accretive acquisitions could drive Link REIT's distribution income growth, which enhances its investment appeal.

Top picks: Link REIT (823 HK), Fortune REIT (778 HK)

Macau gaming

Macau's gross gaming revenue (GGR) dropped by 49.6% y-o-y to MOP2.96bn in Sep 2022, but up 35% m-o-m, as compared to a GGR of MPO2.19bn in Aug 2022, as Mainland China reinstated both package tours as well as eVisas under the Individual Visit Scheme to Macau in late Sep 2022. The move should help to gradually boost Macau's gaming and tourism operations, as seen from about a 300% surge in Macau-related searches on travel guide websites since the reinstatement (source: China Travel News). On a low base, Macau's number of inbound visitors also jumped 1,919% to 0.18m arrivals during the seven-day Golden Week holiday in October, of which 90% came from Mainland China. Daily GGR also climbed to MOP190m during the Golden Week, which was substantially higher than the first week of Sep 2022, although there was still a lot to catch up to versus the daily GGR of MOP1bn during the pre-pandemic Golden Week holidays. Having said that, the market is still focused on the upcoming results of new gaming licenses for casino operations, potentially by Dec 2022.

Top pick: Galaxy (27 HK)

Pharmaceutical and healthcare

We are cautious about the sector, as we estimate public medical insurance programmes will be more stretched financially in 2H22, as they delay payments from small-mid-size corporates. The impact amounts to around Rmb150bn, equivalent to 5% of total income or c.35% of net income in 2021. As a result, the price pressure should remain large. Despite attractive valuations across the sector, we are highly selective. We go for companies with an attractive valuation that is free from price cuts in China. Shenzhen Hepalink (9989 HK) generates >80% of sales from overseas and it is enjoying price surges. Its share price will also be driven by 1) the strong US$, as c.65% of its sales is settled in US$ and 2) a stabilising net margin. Shandong Weigao (1066 HK) is growing its earnings mainly through pharma packaging. Its target customers are pharma companies, not public hospitals and the government. So, its risk of facing price cuts is smaller.

Top picks: Shandong Weigao (1066 HK), Shenzhen Hepalink (9989 HK)

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

Share price appreciation + dividends

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