Manulife Asset Management

2019 Outlook

Hong Kong/China equities

December 2018

Kai Kong Chay
Lead Portfolio Manager

In 2018, Hong Kong/China markets faced a number of challenges resulting in a correction in the equity markets. These include Sino-US trade frictions, deleveraging, and the perception that the central government was favouring stability among state owned enterprises (SOEs) at the expense of the growth of private enterprises. That said, policy adjustments made by the central government in the fourth quarter of 2018[1] showed its intention to stabilise leverage and support private enterprises[2].

Although the recent outcome from the G20 meeting provided a temporary respite from the Sino-US trade friction, we believe this will continue to be an overhang for the medium term. However, the fact that both sides have returned to the negotiating table is a step in the right direction.

Economic growth may rebound in second quarter of 2019

With China and the US agreeing to temporarily suspend tariff hikes in early December 2018, market sentiment should gradually improve. We believe most of the negative news has already been digested by markets. China will also continue to implement fiscal policies to address slower economic growth and provide backing for private enterprises. Macroeconomic data is expected to improve as early as the second quarter of 2019, which should see corporate earnings growth bottom out.

Sector outlook

1. Consumer services stocks

The consumption upgrade trend prevalent in China will continue and should not be impacted by the Sino-China trade friction. We remain constructive on companies in the tertiary education sector, which may benefit from strong structural demand and supportive national policies (e.g. tax allowance for education expenses) and property management companies given that new value-added services and a captive customer base may provide visibility for future earnings growth.

2. New consumer stocks

Market shares of traditional brick and mortar stores have declined steadily as e-commerce continues to gain traction. As disposable income growth in rural areas are outpacing that of their urban counterparts, the opportunities in the tier 3 and tier 4 cities are becoming more apparent. However, given the logistic issues with reaching rural areas, there has been a revival of the traditional landed operators. Among the landed operators, those that consolidated the product mix of their stores based on consumer data, reducing logistics costs, and enhancing the shopping experience are the areas we believe

[1] Xinhuanet, 3 November, 2018. Numerous government agencies have introduced supportive measures for private enterprises over the past half-month. On 19 October 2018, Liu He, Vice-Premier of the State Council, along with the People's Bank of China, China Banking Regulatory Commission and China Securities Regulatory Commission announced a series of measures benefitting private enterprises.

[2] On 20 July, 2018, the Shanghai Securities News published an article by Ruan Jianhong, Chief of Research and Statistics at People's Bank of China, stating that China has entered a stage of leverage stabilisation. On 1 November, 2018, President Xi Jinping hosted a private enterprises conference, which introduced measures to safeguard the interests of private enterprises.

have the greatest ability to capture these new consumer opportunities.

3. **Research and development (R&D) and innovation**

Our focus on research & development and innovation will be emphasising names in the healthcare space. Although there has been a sector-wide overhang given concern of pricing pressure on generic drugs, we believe that consolidation of the industry and a more favourable regulatory environment would provide opportunities for biotech companies investing in the development of new and innovative drugs, particularly in the oncology space. We believe growing demand for innovative drugs would provide a positive long-term growth outlook for the best-in-class companies.

Earnings growth outlook

Looking at the MSCI China Index, markets have lowered estimates of 2019 earnings growth per share from approximately 12 to 13% to 8 to 10%[3]. Forward price-to-earnings (P/E) ratio for 2019 is around 10 times, one standard deviation below the historical average, and not far from the eight times low over the past five years[4]. We believe that most of the uncertainties are already priced in and that the central government's focus to drive domestic growth should result in a more positive outlook for 2019.

Conclusion

In conclusion, 2019 should be a year in which identifying the right opportunities is as important as ever. With that in mind, the investment team will vigilantly manage portfolio risk and adopt a balanced strategy; add beneficiaries of consumption upgrades; and also seek for defensives that expect to offer stable earnings and high dividend yield.

[3] Source: Goldman Sachs Investment Research, 30 June 2018 / 9 December 2018
[4] Source: Goldman Sachs Investment Research, 26 November 2018

Disclaimer

481776,481777