ABCI China /Hong Kong Equity Research

2015 Economic Outlook And Investment Strategy

A Slow-Motion Growth

農銀國際
ABC INTERNATIONAL
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Contents

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2015 Global Economic Outlook and Strategies: A Bird's Eye view

2015 Outlook in Brief

- We believe the U.S. economy is still highly resilient. Key economic indicators are signaling further improvements. The focus of policy makers will be on improving the quality of growth by addressing the underlying issues of inflation and employment. We forecast the U.S. economy will grow by 2.2% YoY in 2014, followed by a 3.2% YoY growth in 2015F

- Eurozone has experienced a downward spiral in growth and inflation; its structural issues have not been fully resolved. Effectiveness of the new stimulus measures, including the QE program, will be revealed by their ability to stimulate growth in 2015. Recovery in the region will be progressive and the pace will vary among member states. We forecast the Eurozone's GDP will grow by 1.2% YoY in 2015F

- Japan will be facing more challenges in 2015 than in 2014. The time to reinvigorate the faltering growth momentum triggered by the sales tax hike is limited. The Abe administration has already ramped up monetary easing but the balance between short-term growth and structural rebalancing has to be struck. We forecast Japan's GDP will expand by 1.0% YoY for 2015F

- Focus of Emerging Asia will be on promoting organic growth. Structural reforms will be the recurring theme in 2015

- In China, infrastructure investment will continue to grow at a relatively fast pace. A combination of accommodative monetary and expansionary fiscal policies will promote more consumption-led growth. We expect China's GDP growth to reach 7.2% YoY for 2015F

- We expect Hong Kong's GDP to expand by 2.4% YoY for 2015F. Key headwinds affecting the local economy include weakening momentum of retail sales, slowdown in property market, and residual impact of the civil campaign. For major stock indices, we expect HSI and HSCEI to reach 26,568 and 13,152 by end-2015F

Investment Highlights

Sector	Rating	Stock Picks
China Banks	Overweight	ICBC (1398 HK) / CCB (939 HK)
Brokerage	Overweight	CGS (6881 HK))
Coal	Neutral	China Shenhua (1088 HK) / Yitai Coal (3948 HK)
Property	Overweight	CSC(1668 HK) / CIFI (884 HK) Sunac (1918 HK)
Railway Sector	Overweight	CRCC (1186 HK), CRG (390 HK), CSR (1766 HK), ZCSR (3898 HK)
Telecom, Media and Technology	Overweight	Tencent (700 HK)
Internet Finance	Overweight	Tencent (700 HK)
Mobile Game	Overweight	Tencent (700 HK)

Source(s):ABCI Securities

Global economy in 2015: A slow-motion recovery

- Rising consumption and private sector investment will hold the key to improvement for the U.S.
- Recovery in Eurozone show signs of floundering; more stimulus measures will be launched
- In Japan, deferral of consumption tax hike will help stabilize economic growth in 2015; the Abenomics needs to follow through on structural reforms
- Emerging Asian markets will see below-trend growth as structural reforms ensue and global recovery remains slow
- China's top priority in 2015 will be to strengthen the massive economic structural reforms underway; credit will be loosened through further interest rate and RRR cuts, along with a mix of targeted liquidity facilities

Global economic recovery to remain slow

In the face of an uneven recovery, the global economy is struggling with the lack of growth momentum. The divergent views among the U.S., Eurozone and Japan on monetary policy increase global variation in liquidity flows. The U.S. Federal Reserve (Fed) takes the lead to normalize monetary policy by terminating the monthly asset purchase and signaling impending rise in interest rates; Eurozone and Japan, confronted with the risks of deflation and another recession, have strengthened monetary easing program and deployed more stimulus policies to boost growth. In sum, the global business environment is facing a complicated monetary policy, creating marked variations in economic conditions that undermine the recovery momentum. Hence, we expect the global economic recovery to proceed slowly in 2015.

In 2014, economic recovery has been more impressive in the U.S. than in Europe and Japan, whose economies are fretted with moderating momentum and disinflation risks. Entering 2015, political gridlock, interest rates hike and changing macro environment could pose risks to the U.S. Especially noteworthy are contradictions of certain employment and consumption data that imply the country's recovery could be less sound than it appears. Nevertheless, strong readings on GDP-related data and job growth suggest consumption and private sector investment will be the key to future economic growth. In Eurozone, most countries show floundering signs of recovery, suggesting that adverse interactions between regional structural problems, government finances, and the struggling economy remain a significant risk. The fragility of Eurozone's recovery will continue to prompt ECB and Eurozone's member states to deepen stimulus measures. In Japan, the initial boosts delivered by the monetary stimulus started to subside. The rise of consumption tax dragged Japan back into recession in 3Q14. With the expansion of QE and depreciation of Yen, Japan's economic activities will continue to be driven by increases in net exports and household expenditures. The deferral of another consumption tax hike, as well as additional stimulus in the form of monetary easing, will help spur economic activities in 2015. For emerging Asia, most economies are in stronger positions to handle fund outflows and the U.S. QE exit. New liquidity resulting from the QE programs in Japan and Eurozone will also help mitigate the impacts of U.S.'s withdrawal. In 2015, EA market will focus on structural reforms and cultivating higher growth potential. We expect the emerging markets will continue to demonstrate below-trend growth as more structural reforms take place.

For China, efforts to strengthen the massive economic structural reforms in progress will be the emphasis of 2015. The fourth plenary session of the 18th central committee held in October asserts that the rule of law is of paramount importance in promoting sustainable development. The session conveys a message that China will maintain a "new norm' of slower economic growth amid economic rebalancing; further credit easing through RRR cut and a mix of targeted lending facilities will be deployed to alleviate the substantial downward pressure in the economy. China's economy is expected to maintain a healthy growth of 7.2% YoY. In Hong Kong, economic growth is expected to improve mildly in 2015 on rebound in external trade and consumption.

Exhibit 1: Global economic forecasts

YoY%	2011	2012	2013	2014F	2015F	2016F
U.S.	1.6	2.3	2.2	2.2	3.2	3.2
Eurozone	1.6	(0.7)	(0.4)	0.7	1.2	1.4
Germany	3.4	0.9	0.5	1.3	1.6	2.0
France	2.1	0.3	0.3	0.5	0.8	1.2
Italy	0.4	(2.4)	(1.9)	(0.3)	0.7	0.8
Spain	0.1	(1.6)	(1.2)	1.1	1.5	1.5
Netherlands	1.7	(1.6)	(0.7)	0.5	1.3	1.8
Greece	(7.1)	(7.0)	(3.9)	0.5	2.5	3.5
Portugal	(1.3)	(3.2)	(1.4)	0.9	1.4	1.7
Ireland	2.8	(0.3)	0.2	3.4	3.2	3.0
UK	1.1	0.3	1.7	3.3	2.6	2.4
Japan	(0.5)	1.5	1.5	0.8	1.0	1.2
Mainland China	9.3	7.7	7.7	7.4	7.2	7.0
Hong Kong SAR	4.8	1.5	2.9	2.2	2.4	3.0
Singapore	6.1	2.5	3.9	3.0	3.0	3.0
South Korea	3.7	2.3	3.0	3.7	4.0	4.0
Russia	4.3	3.4	1.3	0.3	0.4	1.5
India	6.6	4.7	5.0	5.7	6.6	7.2
Brazil	2.7	1.0	2.5	0.2	1.0	1.8

Source(s): IMF, ABCI Securities estimates

U.S.: Gaining more traction

- Compared to other developed economies, recovery of the U.S. economy appears to be strong, with GDP in 2Q and 3Q expanding by 4.6% and 3.5％ QoQ
- The U.S. is embracing a new phase of QE policy in 2015; the Fed is expected to implement the interest rate hike cautiously in a complex market environment
- Contradictions in unemployment and inflation data suggest certain weakness in recovery
- We forecast the U.S. economy will grow by 3.2% YoY for 2015F

Carrying forward the growth momentum

After almost 6 years, the Fed finally put an end to the monthly bond purchase amid an advancing U.S. economy. Starting from Nov. 2014, the Fed will stop purchasing new bonds, but will maintain its current balance sheet size and the low interest rate in the short term. Improvement in the U.S. economy stands out among the Eurozone, Japan and emerging markets. Its overall economy is on a growth trajectory, with employment and inflation staying on track and housing market rekindled; consumers and corporations are turning more positive on the prospects of the economy. The optimism is also reflected in the equity market, with major indices breaking new all-time highs in recent months. We project the U.S. economy will grow by 2.2%YoY in 2014F.

A new phase of QE policy

As the monthly purchase of bonds is now over, we are embracing a new phase of QE. While the Fed would maintain the size of its balance sheet, short-term interest rate rise becomes the focus of the market. Judging from the recent FOMC statements and public speeches by the Fed officials, we believe the U.S. will withdraw from QE in a cautious and gradual manner; its stance toward the impending interest rate hike, however, has become more hawkish. In our view, the Fed will start its first round of interest rate hike in mid-2015.

The market's reaction to the impending interest rate hike, however, has been mixed, partly because the long period of ultra-low interest rate level and new regulations have changed the structure of the bond market. Although the market is more prepared in terms of hedging and asset allocation, we believe liquidity has been reduced since dealer banks are subject to increased scrutiny from regulators. Moreover, low volatility and interest rates have also changed investors' appetite. The market is turning more sensitive, meaning that a sell-off could be triggered more easily.

In addition, the Fed is facing a new challenge. As it is withdrawing from QE, the BOJ and ECB are pumping liquidity into the economy by implementing their own versions of QE. The externally generated liquidity inflow may increase market volatility over time, leading to more policy interventions from the Fed. Moreover, the long period of below-target inflation and low interest rate may have altered investors' expectation, giving the Fed more reasons to undertake its exit with vigilance. We believe the complexity of the economic environment will continue to increase, and the Fed will need to employ more open communication and be cautious in its future policy moves.

Strong recovery needs fundamental support

Compared to other developed economies, the U.S. economic recovery appears to be strong. The setback in 1Q14 did not lead to further decline in 2Q14 and 3Q14, in which GDP grew by 4.6% QoQ and 3.5% QoQ. Consumer confidence rises, and industrial production grows faster. Improvements in the housing market are reflected by the increasing number of building permits, higher house prices, and steady growth in sales of new and existing homes. More notably, the U.S. is enjoying an unprecedented energy boom brought by the shale gas revolution, which helps shield the country from volatile international energy prices.

Despite the overall improvement, we still have two major reservations concerning the employment situation and inflation in the U.S.

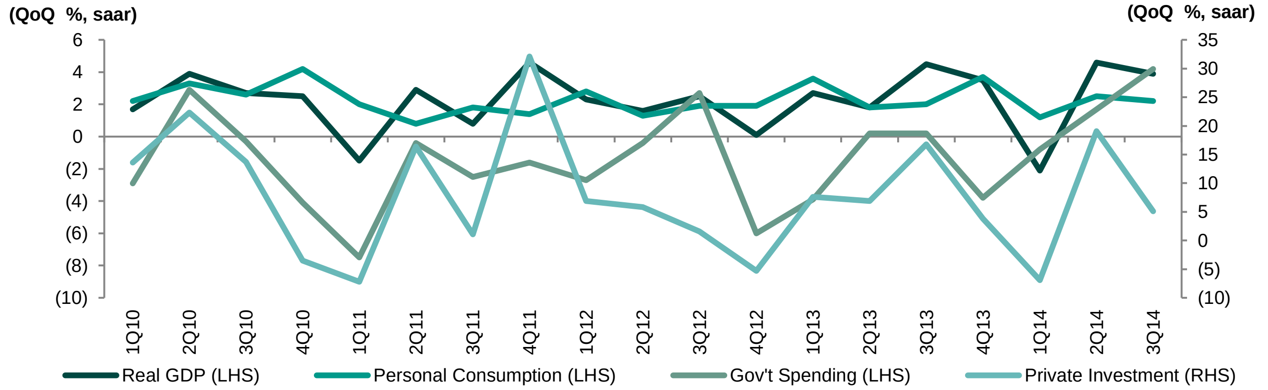
Unemployment rate has fallen from 6.6% to 5.8% since the beginning of 2014, but some employment data suggest the improvement may not be as sound. Labor force participation rate has been declining since Apr 2010; the quality of job remains in question as a high proportion of the working population is employed with part-time jobs. Furthermore, personal income and wage are not growing fast enough to foster consumers' confidence and personal consumption growth.

In addition, inflation, albeit close to the target rate, remains a point of caution. The U.S. headline CPI and the CPI ex. energy and food both stood at 1.7% YoY in Oct. We believe the low inflation at present is partly driven by the fallen energy and commodity prices, which is positive to consumers and will encourage personal consumption. Data suggest that inflation would not reach the Fed's target of 2% YoY in any time soon, as the 10-year U.S. breakeven inflation rate is now standing at 1.7187% YoY. Inflation that persistently lags behind target would create an entrenched expectation of low inflation in the future, shifting the market's consumption and investment pattern, and ultimately creating a downward spiral in the inflation trend and the public's confidence on the Fed's policy execution ability.

Gaining more traction in 2015

We believe the U.S. economy is still highly resilient. Key economic indicators are signaling further improvements. The focus of policy makers will be on improving the quality of growth by addressing the underlying issues of inflation and employment. Another critical factor is whether the Fed can handle the interest rate rise tactfully. We believe interest rate hike will start in an orderly manner with other complementary tools to ensure a smooth transition in the market. The interest rate hike has already been priced in but the capital market would nonetheless be affected during the process. Hence, we forecast the U.S. economy will grow by 3.2% YoY for 2015F.

Exhibit 1: U.S.'s GDP growth



Source(s): Bloomberg, ABCI Securities

Exhibit 2: U.S.'s equity indices in 2013 and 2014

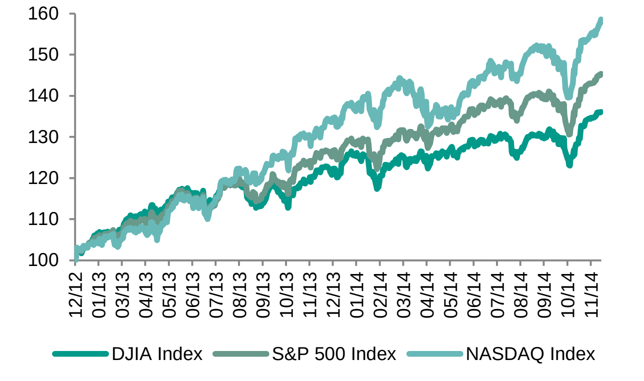
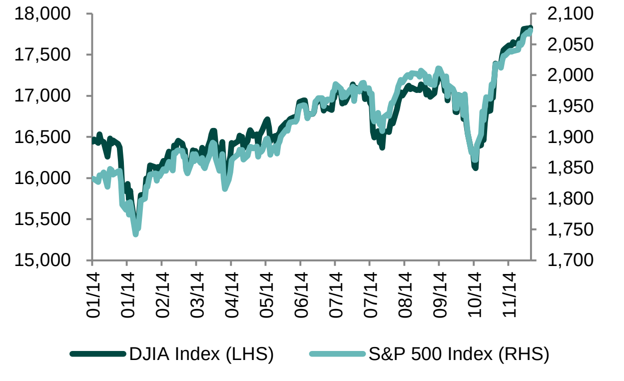
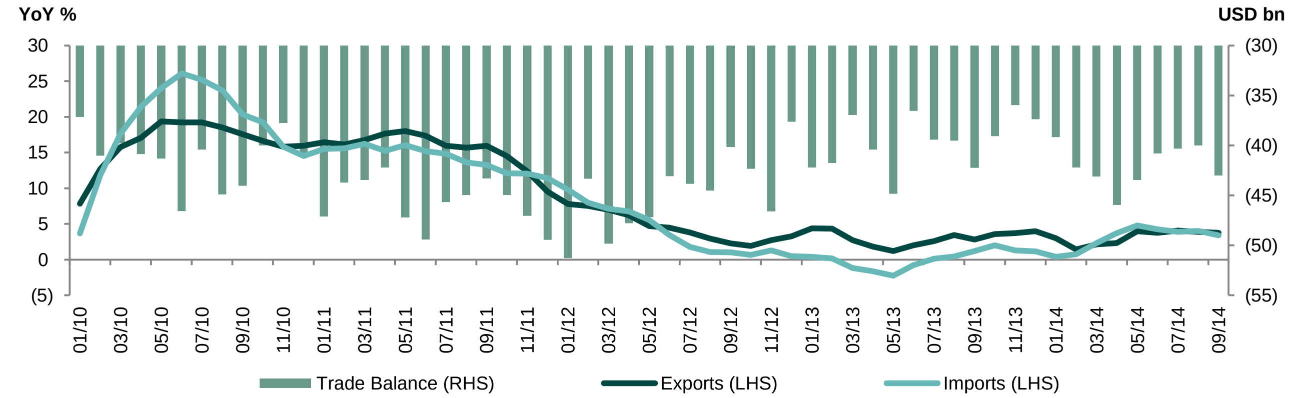


Exhibit 3: DJIA Index and S&P 500 Index in 2014



Note: For Exhibit 2, baseline = Dec 31, 2012
Source(s): Bloomberg, ABCI Securities

Exhibit 4: U.S.'s trade balance, 3MMA export and 3MMA import growth



Source(s): Bloomberg, ABCI Securities

Exhibit 5: The number of jobless claims is declining in the U.S.

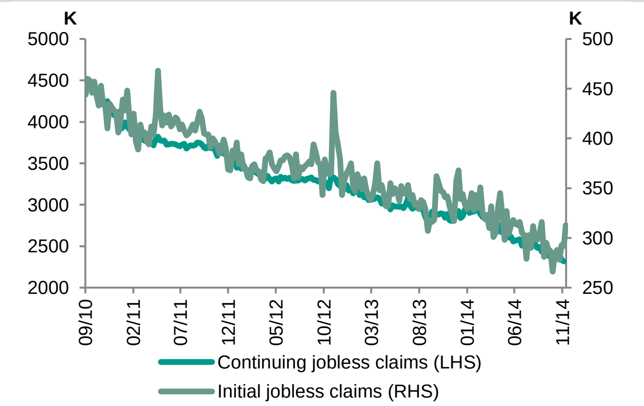
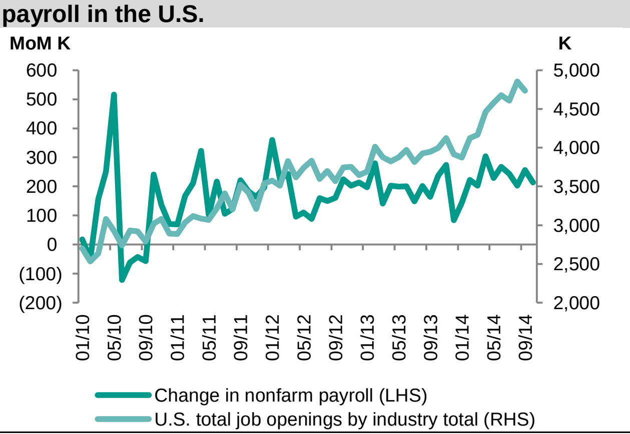
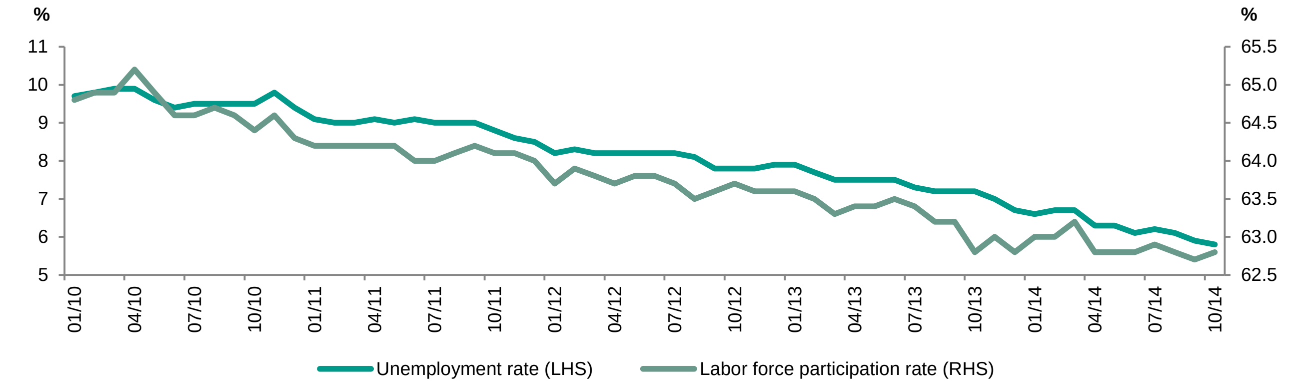


Exhibit 6: Job openings and change in non-farm payroll in the U.S.



Source(s): Bloomberg, ABCI Securities

Exhibit 7: U.S.'s unemployment rate and labor force participation rate



Source(s): Bloomberg, ABCI Securities

Exhibit 8: U.S.'s PMI

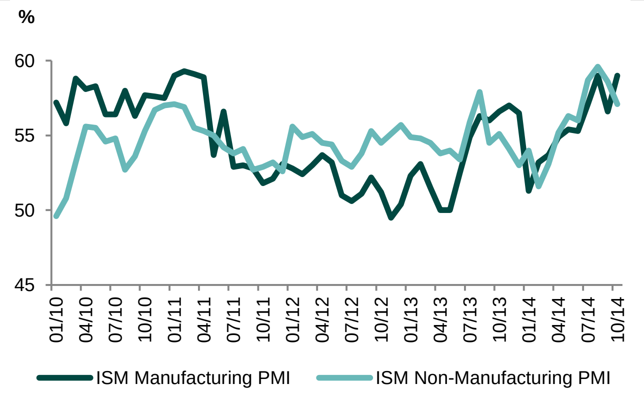
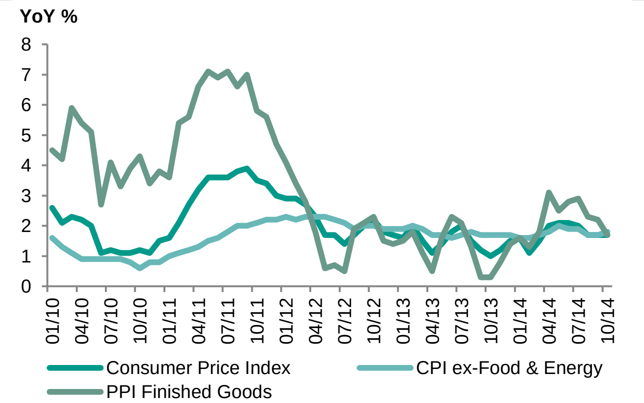


Exhibit 9: U.S.'s inflation rates – CPI & PPI



Source(s): Bloomberg, ABCI Securities

Exhibit 10: U.S.'s new and existing home sales

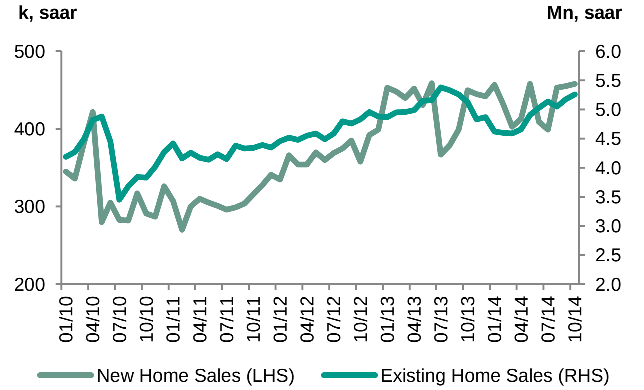
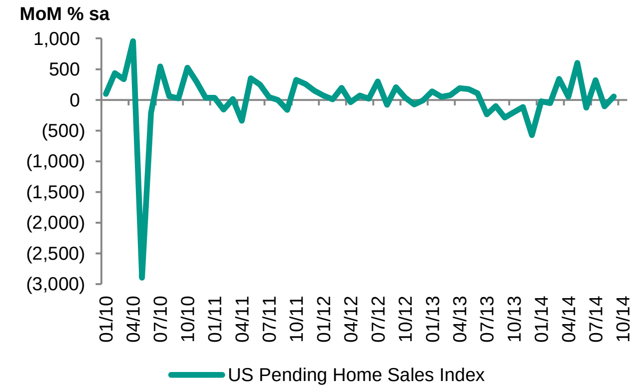


Exhibit 11: U.S's pending home sales change



Source(s): Bloomberg, ABCI Securities

Exhibit 12: MBA mortgage application in the U.S.

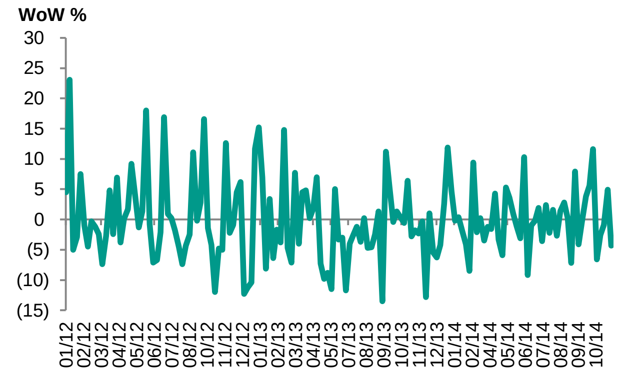
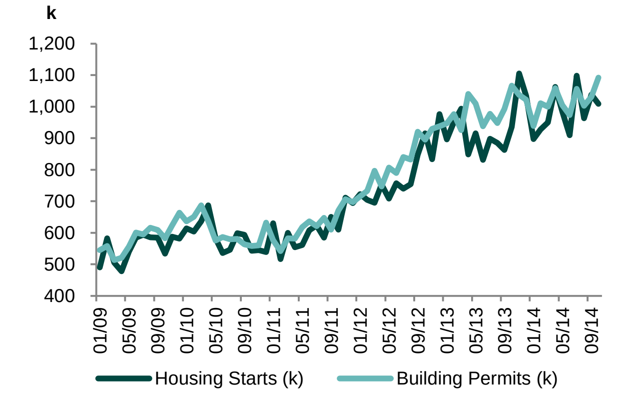


Exhibit 13: U.S.'S housing starts and building permits



Source(s): Bloomberg, ABCI Securities

Exhibit 14: U.S.'s industrial production

Exhibit 15: U.S.'s factory orders and durable goods orders

Source(s): Bloomberg, ABCI Securities

Exhibit 16: U.S.'s capacity utilization

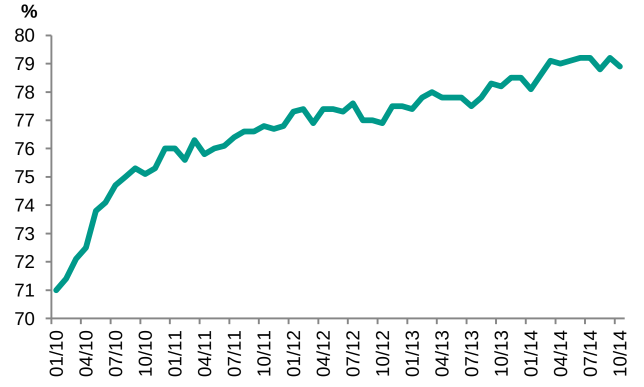
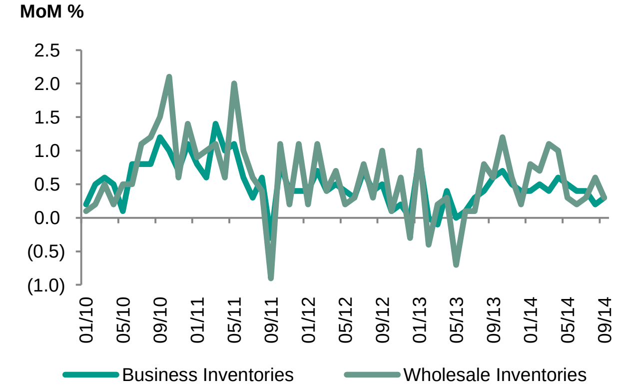


Exhibit 17: U.S. inventories change



Source(s): Bloomberg, ABCI Securities

Exhibit 18: U.S. personal income, expenditure, and consumer confidence

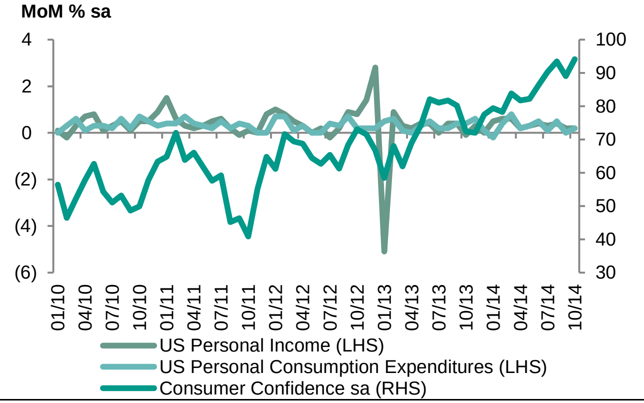
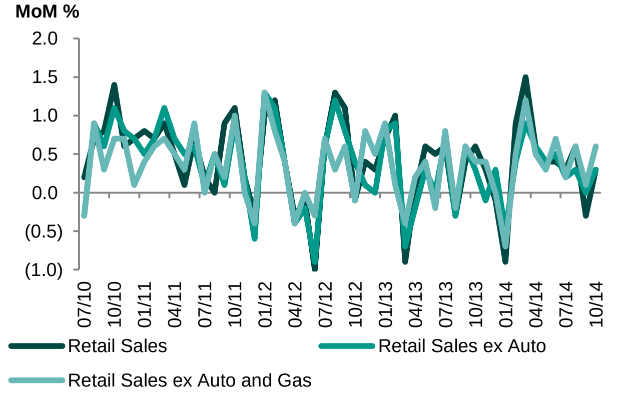
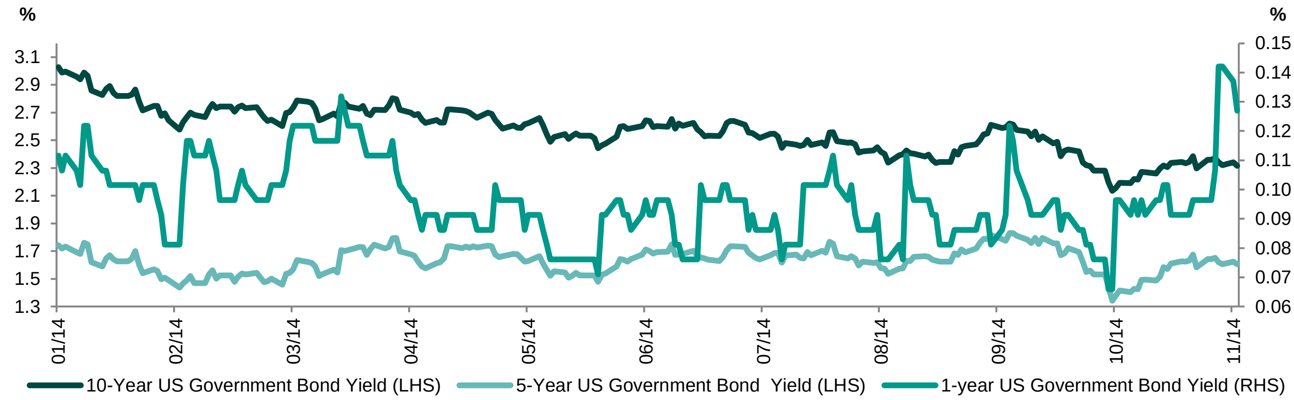


Exhibit 19: U.S.'s retail sales growth



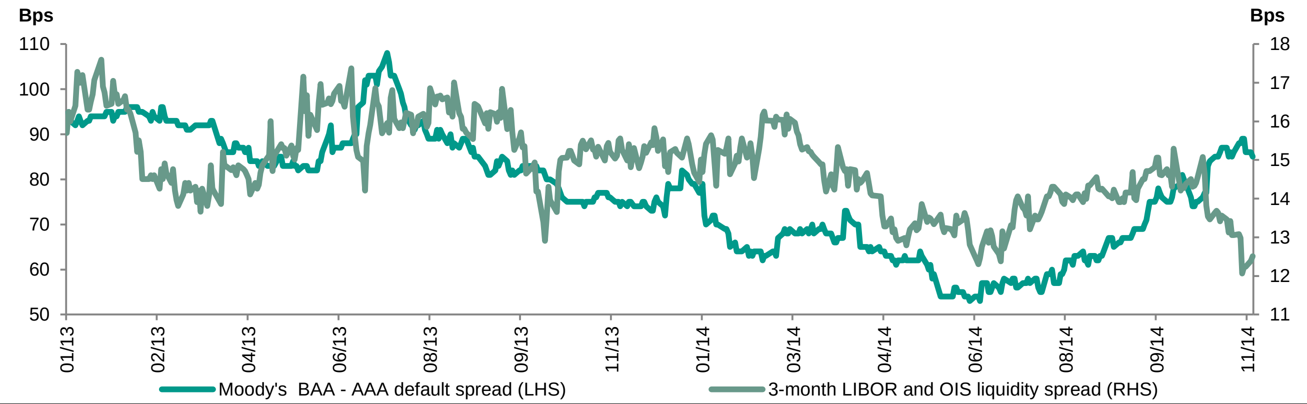
Source(s): Bloomberg, ABCI Securities

Exhibit 20: U.S government bond yields in 2014



Source(s): Bloomberg, ABCI Securities

Exhibit 21: U.S Liquidity spread and default spread



Source(s): Bloomberg, ABCI Securities

Eurozone: Facing its own test

- Eurozone has been underperforming relative to its targets. GDP growth of the region remains stagnant , expanding by 0.1%-0.3% in 1Q- 3Q14
- Previous policy tools were not effective in triggering growth, while effectiveness of new policies remains to be seen
- QE could give Eurozone the necessary boost, but structural problems and the economic environment may reduce its effectiveness
- We forecast the Eurozone GDP will grow by 1.2% YoY in 2015F

The tides are turning

The Eurozone has been underperforming relative to its targets and other economic entities. GDP growth of the region remained in doldrums, expanding by a meager 0.2% QoQ in 3Q14 after two quarters of slow growth (0.1% QoQ for 2Q14 and 0.3% QoQ for 1Q14). Performance of its core members varies. Germany and France dodged a technical recession with GDP growth of 0.1% QoQ and 0.3% QoQ in 3Q14; Spain performed steadily, while Italy has failed to demonstrate growth since 2011. In contrast, some peripheral countries are witnessing stronger recovery. Greece, one of the hardest-hit states in the Eurozone debt crisis, recorded a GDP growth of 0.7% QoQ in 3Q14, the fastest growth in 6 years. Meanwhile, Eurozone has not been successful in escaping the deflationary trap. The region's CPI has been on a downtrend since Sep 2013 and stood at 0.3% YoY in Nov 2014, well below the ECB's target rate. Eurozone is in a precarious position – the fear is that the combination of low growth and near-zero inflation would induce a Japan-like lost decade. In light of these negative factors, we expect that the Eurozone economy will grow by 0.7% YoY in 2014F.

Boosting the effectiveness of stimulus measures

Despite the support offered by the Eurozone authorities, the real economy has not been able to take flight. Previous programs were ineffective and did not result in easier access to credit for private sector, especially the SMEs. The policies also led to the unintended build-up of financial risks as low-cost financing was used by investors to pursue higher yields.

Policy makers are coming up with more measures to tackle with the issue of insufficient economic risk-taking. The ECB cut main refinancing rates to 0.05% and the central bank's deposit rate to -0.2% in July, 2014. In Sep 2014, the ECB launched the TLTRO (Targeted Long-Term Refinancing Operations) to channel more liquidity into the non-financial private sector. However, take-up of the first round only reached €82.6bn, much lower than the theoretical cap of €400bn and market expectation. More recently, the European Commission announced the European Fund for Strategic Investment (EFSI) that aims to use small amount of public funding to obtain large amount of private capital to support sizeable investment projects across the EU. But how the EFSI program is perceived by investors and whether it will achieve the intended effects will remain to be seen.

We believe these measures will offer some support to the economy, and more measures will be launched to develop the real economy to be launched. However, these new measures will need the support of detailed planning and careful execution in order to be successful. We believe a more targeted approach will be a better solution given the unique challenges faced by each member state.

QE is no panacea for Eurozone's problems

The combination of low growth and near-zero inflation prompted ECB to take actions against the possible occurrence of a lost-decade situation. The central bank has not deployed a full-blown quantitative easing resembling the ones in the U.S. and Japan as many expected. The ECB so far has covered bonds and asset-backed securities on its list of purchase and has been considering sovereign bonds and corporate bonds purchase as well. However, we are cautious on the impact of QE on Eurozone's recovery at the current stage.

The underperforming economy is a manifestation of deep-rooted fundamental issues. The formation of a Eurozone banking union, which has long been part of the structural reform agenda, is still proceeding slowly. Only the Single Supervision Mechanism, one of the three pillars of the Eurozone banking union, started operating this Nov. Another factor undermining the growth in the Eurozone is the lack of fiscal union and to a certain extent, a political union. Discord over fiscal policy has intensified as some Eurozone member nations are concerned that rigid implementation would hamper the already anemic growth.

The new round of QE may fail to spur inflation as intended. The currently low inflation, measured by CPI, was mainly influenced by the declining energy prices (liquid fuel in particular) in the international market. Breakdown of the Eurozone CPI indicates inflation in services is on the rise while that of goods remains mild. The QE measure could render ineffective in reflating the economy if the energy prices continue to fall. Moreover, in our view, the Eurozone economy relies more on banks rather than the capital market for financing. Therefore, effectiveness of ECB's QE could be different from that of the U.S.

Fiscal discipline – more cons than pros

The economic quandary complicating the current economic landscape also includes the austerity measure that is facing more opposition from the Eurozone member nations. France and Italy are concerned that the fiscal discipline will restrain growth. Even Germany, the faithful advocate of austerity measures, finds it difficult to supporting the policy as its economic growth slows.

We believe the negative implications of the fiscal austerity measures outweigh the positive ones. Fiscal discipline will help the Eurozone member nations lower the leverage level and reduce credit risk; the combination of loose monetary policy and tightened fiscal measures has caused significant depreciation of the Euro, which is beneficial to the external trade. However, austerity measures are preventing Eurozone member nations to adopt the much-needed fiscal policies to increase public investment and boost domestic demand. To devote more resources for pro-growth initiatives in 2015, we expect some member nations will gain concessions on the fiscal austerity measures by delaying the deadline of meeting deficit targets.

2015 is critical year for Eurozone

Substantial pressure will persist in the Eurozone in 2015. Effectiveness of the new asset purchase program, the TLTRO program, and the new EFSI program will be measured by their ability to foster growth, increase inflation, and lower unemployment. At the same time, member countries will need to carry out structural reforms to achieve more sustainable growth. The Eurozone authorities should devote more efforts to promote fiscal unity and facilitate the formation of the European Banking Union. Recovery will be progressive and the pace will vary among member states. We forecast the Eurozone GDP will grow by 1.2% YoY in 2015F. Germany, France, Italy, and Spain, the core members of the Eurozone, will see GDP growth of 1.6% YoY, 0.8% YoY, 0.7% YoY, and 1.5% YoY, respectively.

Exhibit 1: Eurozone's GDP growth

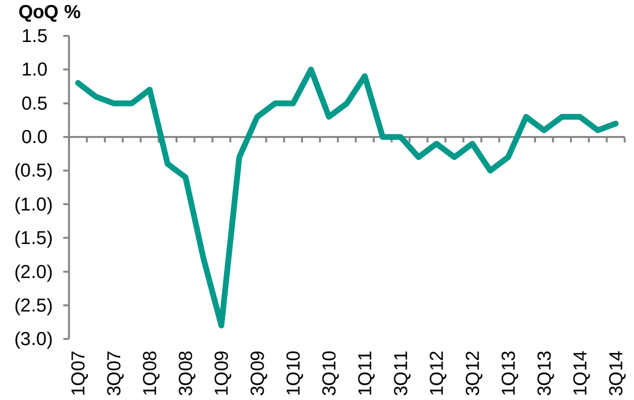
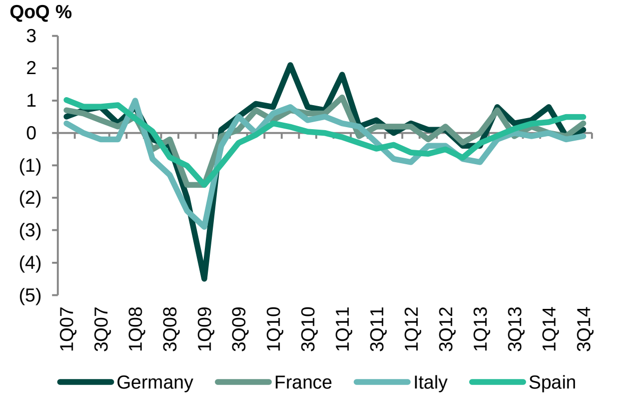


Exhibit 2: GDP growth of major Eurozone member states



Source(s): Bloomberg, ABCI Securities

Exhibit 3: Eurozone's current account balance

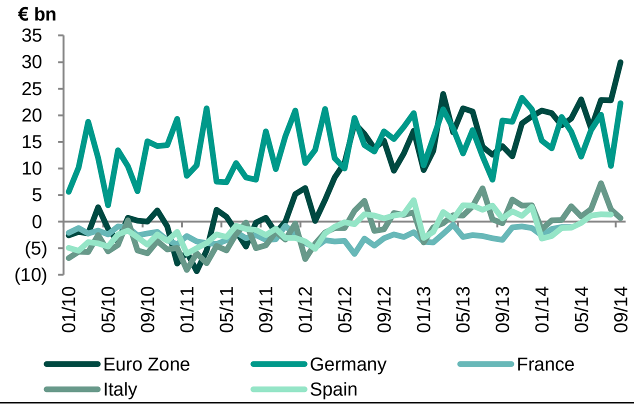
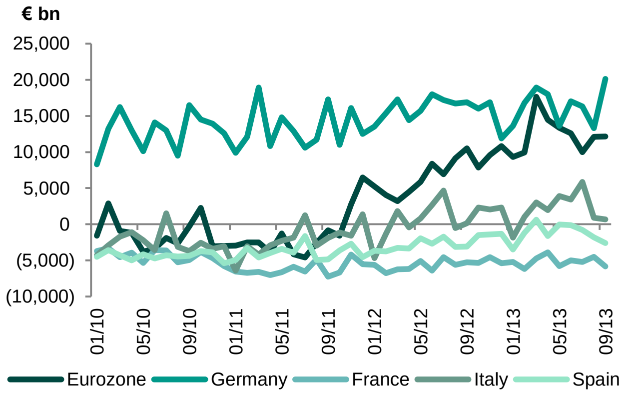


Exhibit 4: Eurozone's trade balance



Source(s): Bloomberg, ABCI Securities

Exhibit 5: Eurozone's PMI

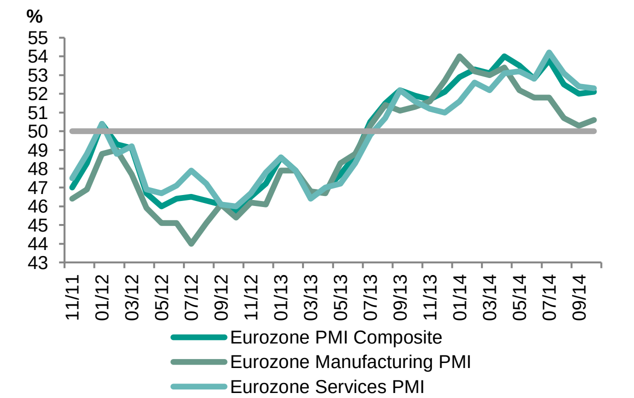
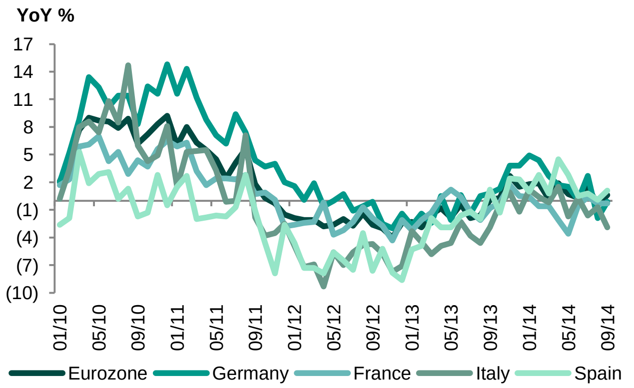


Exhibit 6: Eurozone's industrial production growth



Source(s): Bloomberg, ABCI Securities

Exhibit 7: CPI of Eurozone and major Eurozone member states

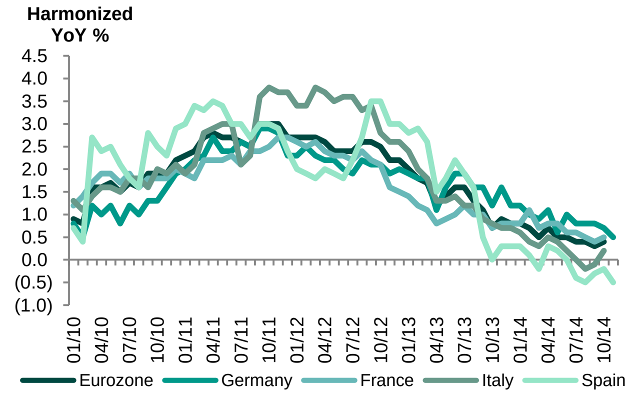
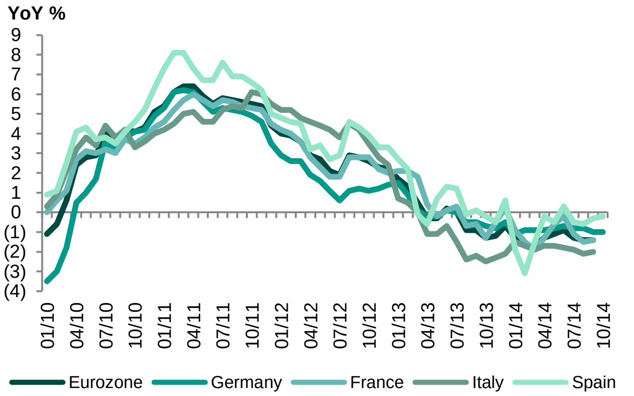


Exhibit 8: PPI of Eurozone and major Eurozone member states



Source(s): Bloomberg, ABCI Securities

Exhibit 9: Eurozone's unemployment rate

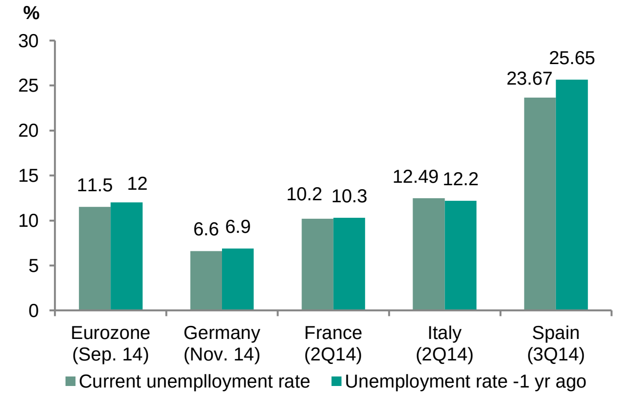
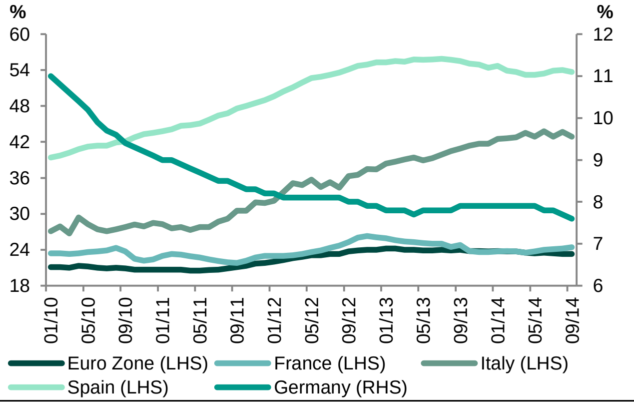


Exhibit 10: Eurozone's unemployment rate – age 25 or under



Source(s): Bloomberg, ABCI Securities

Exhibit 11: Eurozone's retail sales growth

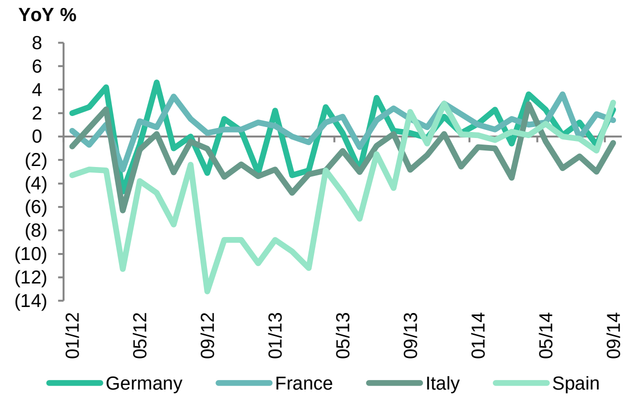
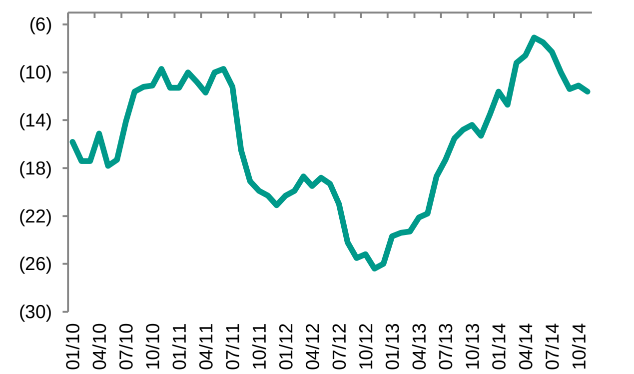


Exhibit 12: Eurozone's consumer confidence



Source(s): Bloomberg, ABCI Securities

Exhibit 13: Budget deficit (surplus)/GDP in Eurozone

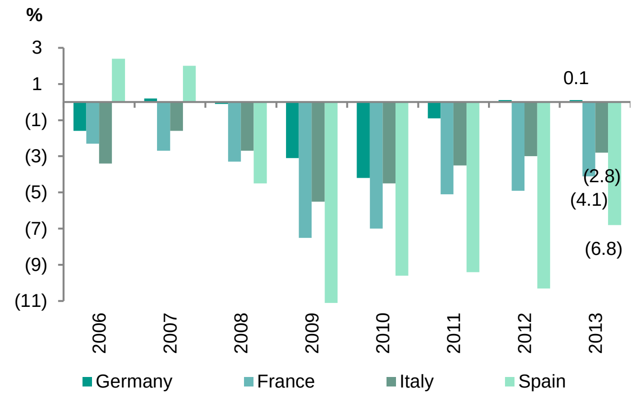
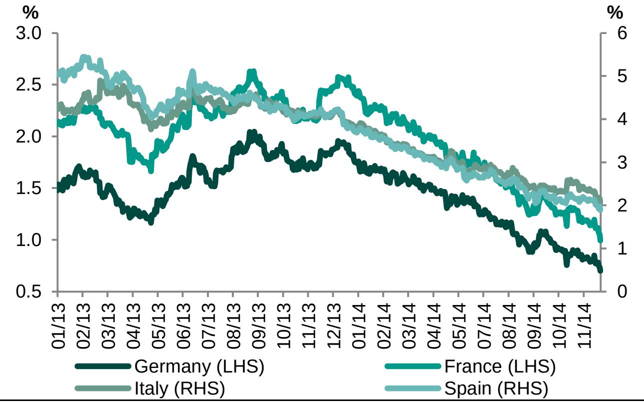


Exhibit 14: Eurozone's government debt/GDP



Source(s): Bloomberg, ABCI Securities

Exhibit 14: Eurozone's 10-year government bond yield

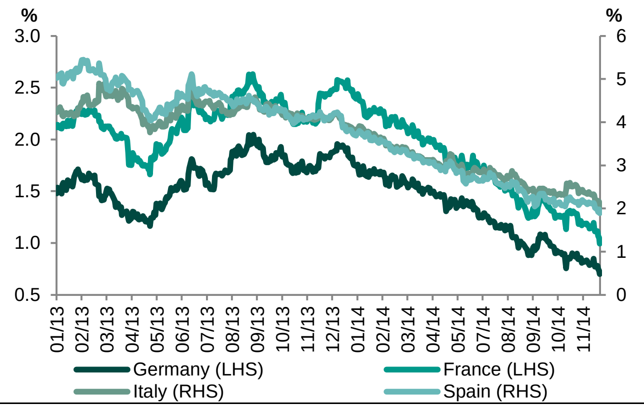
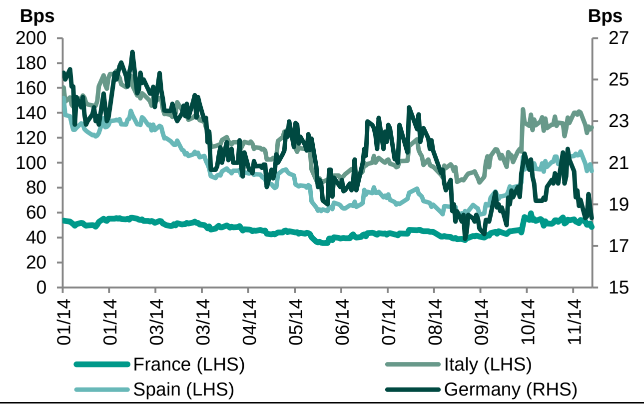


Exhibit 15: Eurozone's 5-year CDS spread



Source(s): Bloomberg, ABCI Securities

Exhibit 16: ECB's rate reduction moves

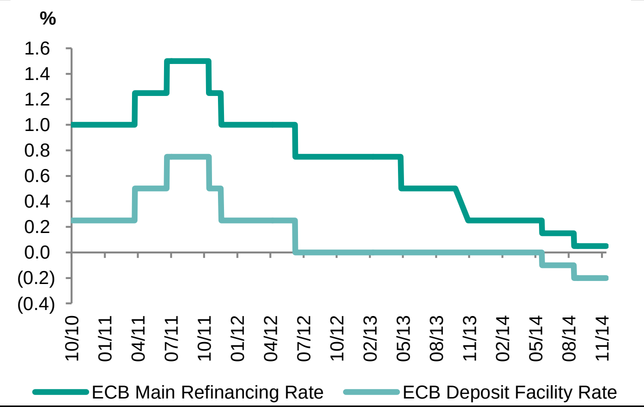
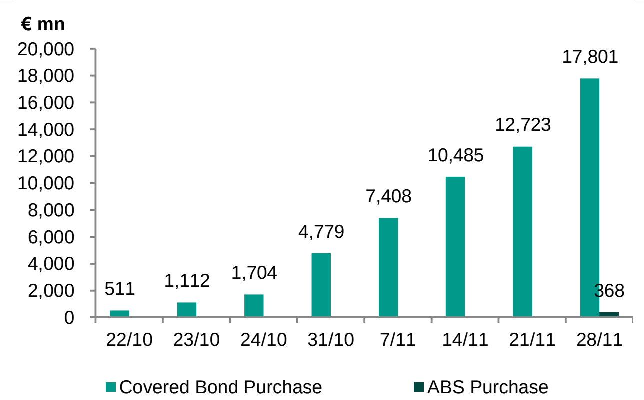


Exhibit 17: Progress of Eurozone's QE program



Source(s): Bloomberg, ABCI Securities

Japan: Abe's bet

- Japan's economic momentum slowed on the sales tax hike and diminishing impacts of the Abenomics policy
- Delay of the second sales tax hike would give the government more time to revive the economy
- Abe administration needs to ramp up the "third arrow" by accelerating its structural reform agenda
- We forecast that the country's GDP will expand by 1.0% YoY for 2015F

Abenomics is malfunctioning

Japan has fallen into a technical recession in 3Q14. Its GDP growth contracted at an annualized rate of 1.6% QoQ in 3Q14, after declining by 7.3% QoQ in the previous quarter. The Abenomics had somewhat propelled the Japanese economy initially, but the increase in sales tax rate from 5% to 8% in Apr deterred consumer spending, dampening the economic momentum. On the policy side, we have seen Prime Minister Shinzo Abe and his administration strengthening the first two "arrows", namely, monetary easing and fiscal stimulus. However, structural reform, which is the third arrow of Abenomics, has been sidelined in 2014. The consolation is that the equity market has been rising since May 2014. The announced change in asset allocation of Government Pension Investment (GPIF) and the expansion of the Qualitative and Quantitative Easing (QQE) gave the market an additional push at end-Oct. We expect the Japanese economy will expand by 0.8% YoY in 2014F.

Stuck between a rock and a hard place

Raising the sales tax in April was a miscalculated move by the Abe administration. Retail sales declined by 4.3% YoY in Apr and household consumption fell 5.2% MoM in 2Q14 after the tax was first implemented. The impact of the tax hike lingered in 3Q14 despite gradual improvement in household consumption and retail sales. All these indicate the Japanese economy is still too fragile to embrace another round of sales tax hike.

The postponement of the next sales tax hike (from 8% to 10%) announced by the Japanese government was more than just a gesture of good will. By deferring the sales tax hike for 18 months, the Abe administration will have more time to revive the economy and restore inflation to a healthier level. Our main concern lies on the government's ability to complete these goals in such a short period; moreover, the urgency to stimulate growth may prompt the government to seek for pro-growth shortcuts and further augment the tendency to procrastinate the long-awaited structural reform, sacrificing the country's long-term sustainability for short-term growth.

"Third Arrow" to unleash higher growth potential

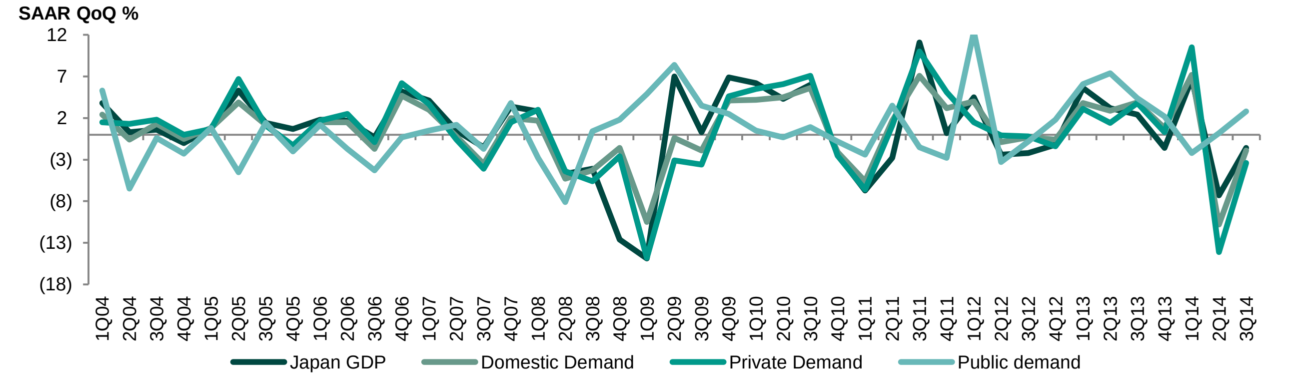
Fiscal stimulus and monetary easing brought by the first two "arrows" are showing signs of fatigue. The monetary easing policy has not been able to benefit all levels of the society, sparking debates on inequality in the next election. Adverse effects of the continuous depreciation of Yen may outweigh the benefits of increased exports. The increasing inflation, as measured by the nationwide CPI, was partly driven by the sales tax hike. Excluding the tax increase, inflation was around 1% YoY in Oct. To make matters worse, the declining energy prices are exerting downward pressure on Japan's CPI.

Under the current circumstances, a structural reform is much needed. The latest move to redirect a higher portion of the GPIF investment to equity was a relatively easy task to accomplish. The real difficulties lie on reforms such as improving the rigid employment structure, increasing female participation rate in the workforce, enhancing the immigration system, and introducing more legal changes to provide more growing space for industries. For now, the Abe administration needs to provide more follow-up policies for the announced structural reform to sustain momentum of the "third arrow".

A more challenging 2015

Japan will be facing more challenges in 2015. The ramp-up of monetary easing will create more pressure on the currency, which could be beneficial to exports; the BOJ, however, will need to balance the resultant inflation and decreased purchasing power. The Abe administration will have to attain the short-term growth and inflation targets while continuing its prolonged fight against structural problems. We remain hopeful that the Abe administration will achieve certain short-term targets and forecast that the country's GDP will expand by 1.0% YoY for 2015F.

Exhibit 1: Japan's GDP growth



Source(s): Bloomberg, ABCI Securities

Exhibit 2: Nikkei 225 Index and TOPIX Index edged up

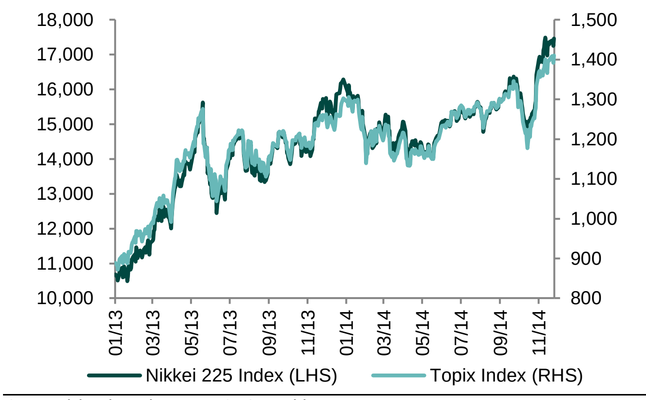
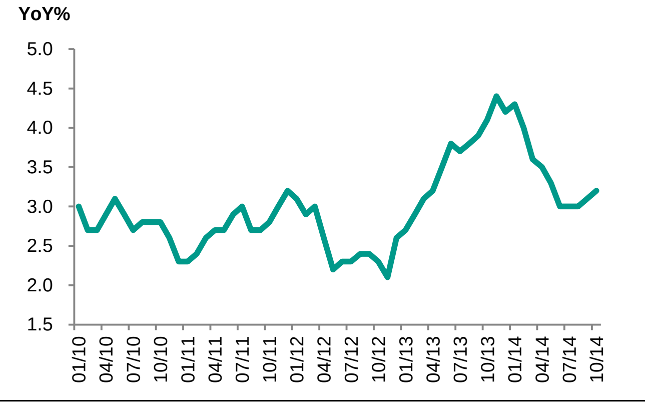


Exhibit 3: M2 growth in Japan



Source(s): Bloomberg, ABCI Securities

Exhibit 4: Japanese Yen depreciates against the USD

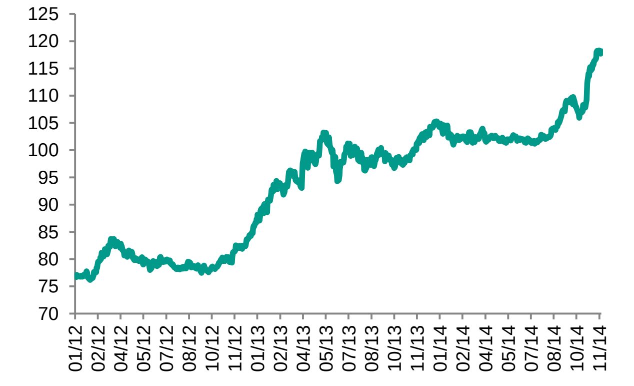
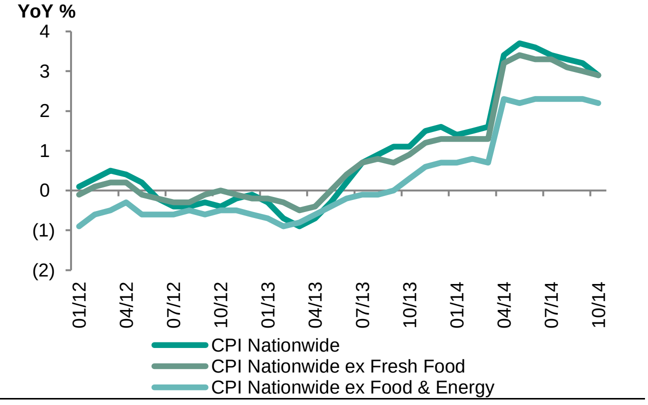


Exhibit 5: Inflation in Japan



Source(s): Bloomberg, ABCI Securities

Exhibit 6: 3MMA exports and imports growth in Japan

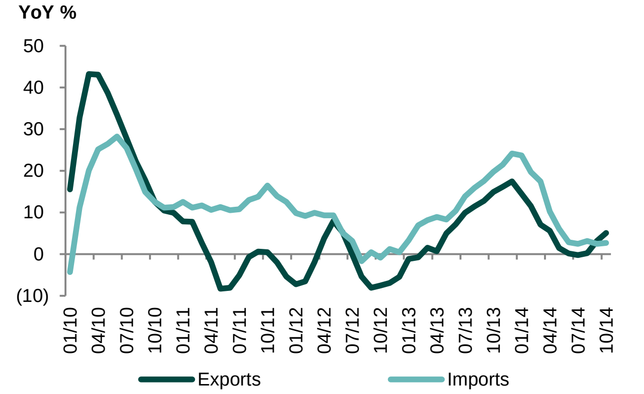
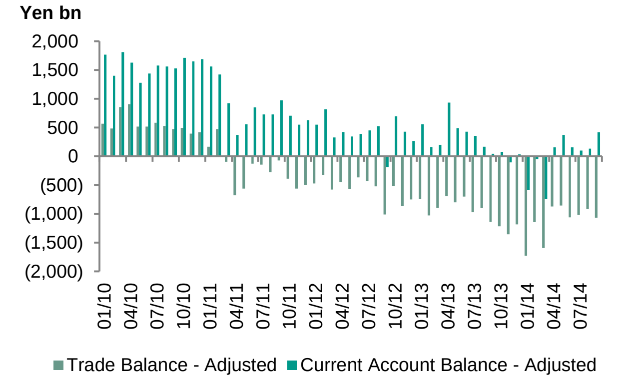


Exhibit 7: Trade balance and current account balance in Japan



Source(s): Bloomberg, ABCI Securities calculation

Exhibit 8: Growth in industrial activities in Japan

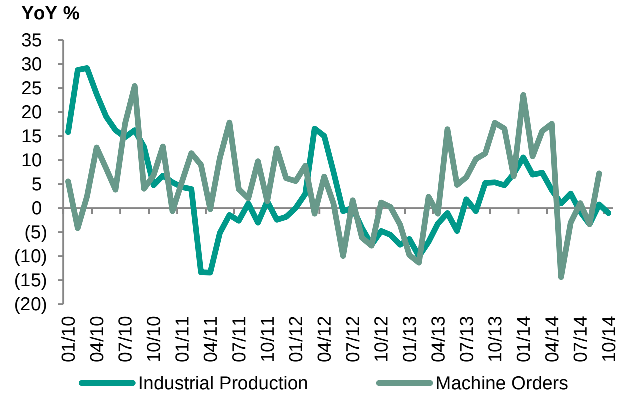
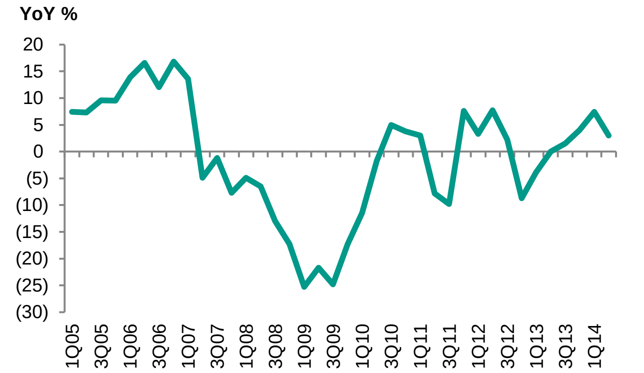


Exhibit 9: Capital investment growth in Japan



Source(s): Bloomberg, ABCI Securities

Exhibit 10: Retail sales and household income growth in Japan

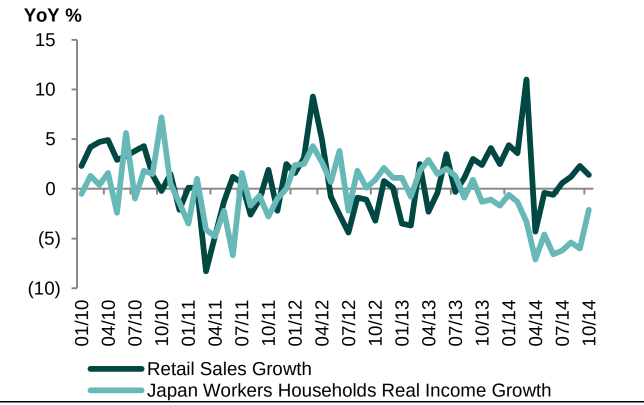
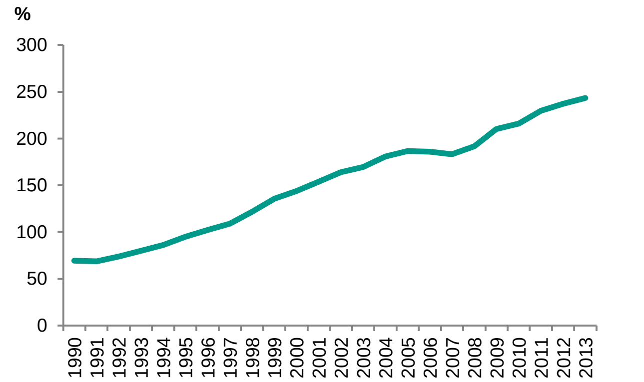


Exhibit 11: Government debt/GDP in Japan



Source(s): Bloomberg, ABCI Securities

Emerging Asia: Structural reform in focus

- Impacts of Fed's ceasing its monthly bond purchase have been mild so far, indicating investors have already priced in such actions
- In India, Prime Minister Modi 's latest reforms to improve the government efficiency would lay the background for more pronounced changes in the future
- ASEAN will see uneven pace of growth among its members
- Focuses of the EA will be on fostering organic growth and structural reforms for 2015

External shocks subsides

Emerging Asia (EA), defined as India and ASEAN, has risen from the QE shadow in 2014. Unlike before, the latest announcements on reduction and the eventual termination of monthly bond purchase program has not triggered massive sell-off in the EA equity markets or significant currency depreciation. We believe investors' anticipation of the exiting moves, accelerating growth in EA, and gradual alleviation of structural problems have reduced market reactivity. Although external impacts are becoming less pronounced, the fundamental issues of EA still warrant concerns. While progresses have been made, more needs to be done to improve the balance sheet, overall productivity, and infrastructure investment. Now that the external environment has turned more accommodating, EA in 2015 will be able to achieve better growth and more structural reforms.

A possible destination for new liquidity

Impacts of Fed's ceasing its monthly bond purchase of bond on the EA markets have been mild so far, indicating investors have already factored in such moves. In addition, countries around the world are committed to reignite growth. Eurozone and Japan have started their own versions of QE, while China has also deployed various monetary stimulus policy tools. The global markets will once again enjoy ample liquidity in 2015.

Although the pledge for growth is clear, the prospect of the global economy is less certain. The U.S. is the only major economy showing consistent recovery, while Eurozone and Japan slipped back into low growth or recession. We expect the global uncertainty will favor EA economies as investors seek to park liquidity in these regions for higher yields and better opportunities. The focus of EA now should be more on developing the economy and improving structural soundness.

India: more structural reforms to come in 2015

Narendra Modi, the newly elected Prime Minister of India, has been initiating economic reform to modernize India's economy. So far, his focus has been on improving the government's efficiency. The reform measures so far are not what the "Big Bang" reforms the market hoped for; nonetheless, we believe they will lay the groundwork for more profound changes. In addition, as Modi administration and the ruling Bharatiya Janata Party (BJP) consolidate their power in the state government, Modi shuld be able to conduct further fundamental reforms more efficiently.

We also believe that India will need to conduct reforms that address the most pressing issues in the economic system. India will need to ensure continuation of the current reforms and roll out policies with the goals of unifying the country's market with a single goods and services tax system, creating a more accommodating business environment for foreign investors, enhancing infrastructure investment, and restoring the country's fiscal health. With affirmative actions, we believe Modi will be able to transform India's economy.

ASEAN is still a work-in-progress

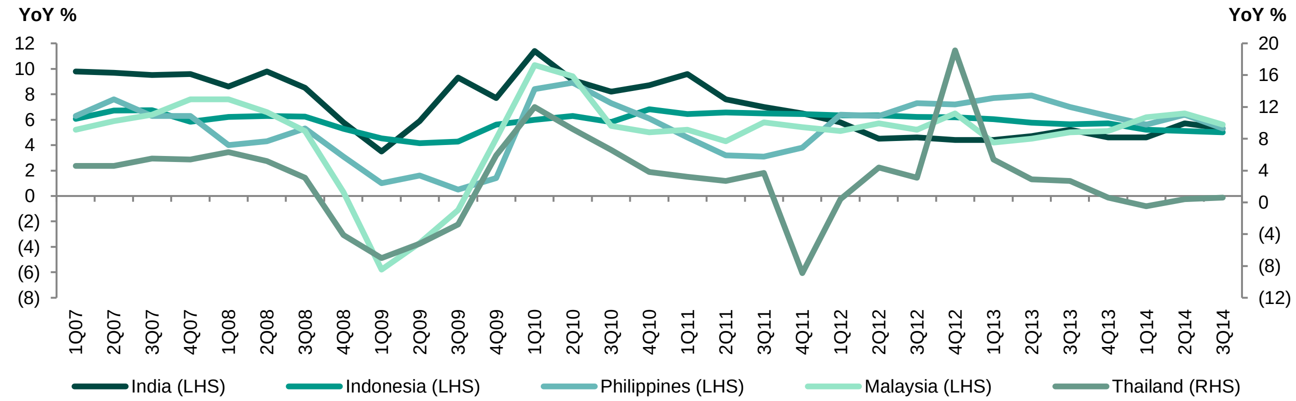
The ASEAN economy has been stable in 2014. The impact of external shocks has diminished; fund outflow has also been reversed. The region's economic fundamentals are gaining strength, as current account surplus and inflation are both improving among the member nations. Similar to many emerging markets, the ASEAN has been afflicted by structural issues. The lack of infrastructure investment, low productivity, and imbalance in the fiscal budget are the common problems shared by its member nations. In addition, economic integration under the ASEAN framework is lagging behind on differences in political and economic interests.

We are still optimistic on the region's prospect in 2015, despite uneven growth among the member nations. Except for Malaysia, whose economy is dependent on oil and energy exports, the declining oil price will be favorable to most countries and their current accounts. With the Trans-Pacific Partnership Agreement (TPP) negotiation coming to completion, we believe Vietnam will be a bright spot. The country's manufacturing sector will be boosted as companies have been increasing investment in the region on the anticipation of favorable trade policies under the TPP framework. Growth in Indonesia will be largely stable, but political hurdles for the newly elected President Joko Widodo will present challenges. Philippines's economic momentum will slow as domestic demand falls and global recovery is still lethargic.

Fostering organic growth in 2015

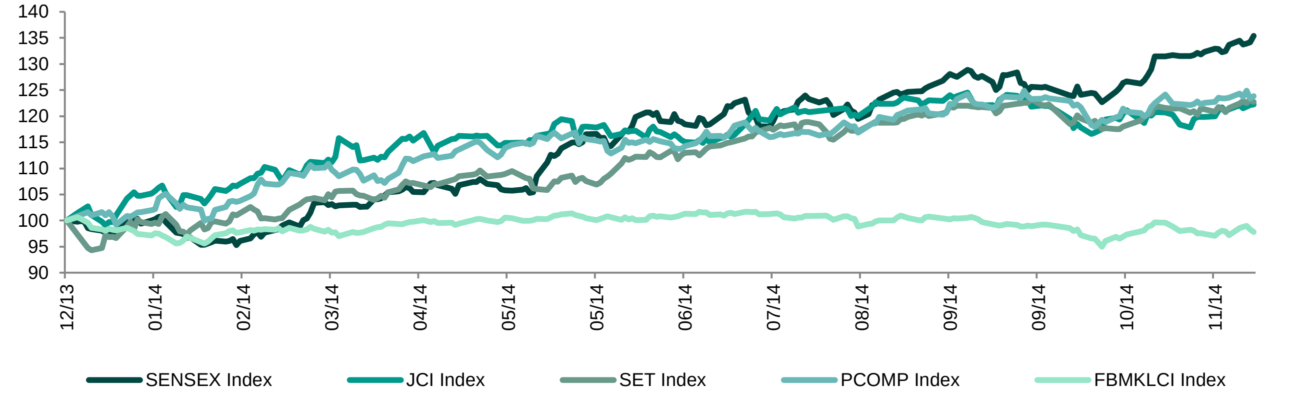
Focus of the EA will be on promoting organic growth. Also, structural reforms, which will be a recurring theme in 2015, should help the local governments to improve efficiency and productivity, increase consumption, and unleash more growth potentials. In this way, EA members could enhance their competiveness and attract more foreign capital. While these structural reform measures will weigh on growth in certain countries, the long-term benefits should outweigh the short-term pains.

Exhibit 1: GDP growth in Emerging Asia



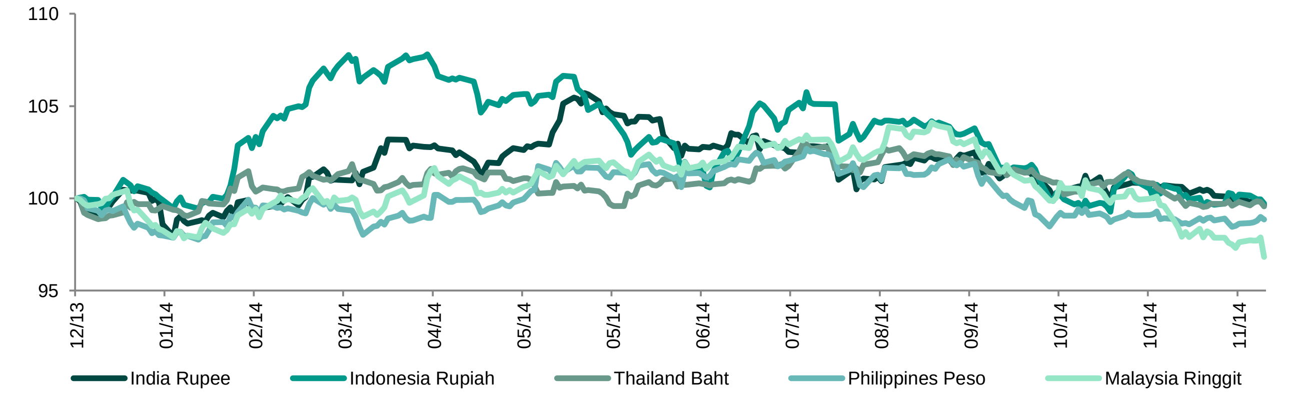
Source(s): Bloomberg, ABCI Securities

Exhibit 2: Emerging Asia's stock indices in 2014



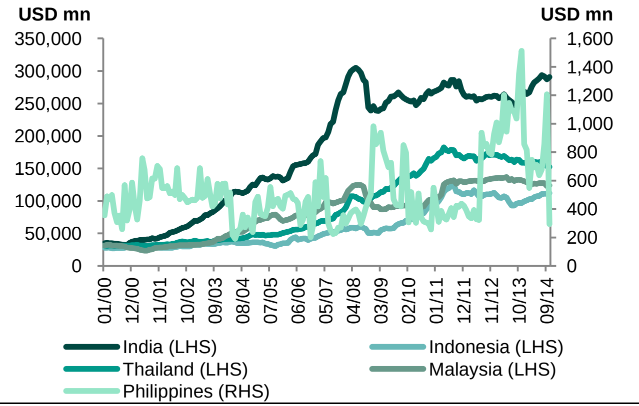
Note: Baseline = Dec 27, 2013
Source(s): Bloomberg, ABCI Securities

Exhibit 3: Emerging Asia's currencies in 2014



Note: Baseline = Dec 31, 2013; all currency values are against USD
Source(s): Bloomberg, ABCI Securities

Exhibit 4: International reserve in Emerging Asia



Source(s): Bloomberg, ABCI Securities

Exhibit 5: Current account balance/GDP in Emerging Asia

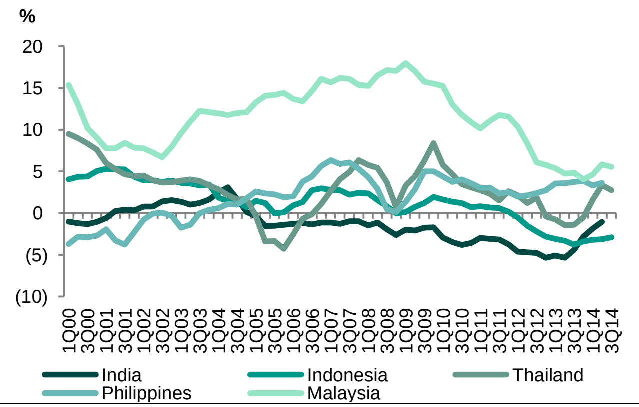


Exhibit 6:3MMA export growth in Emerging Asia

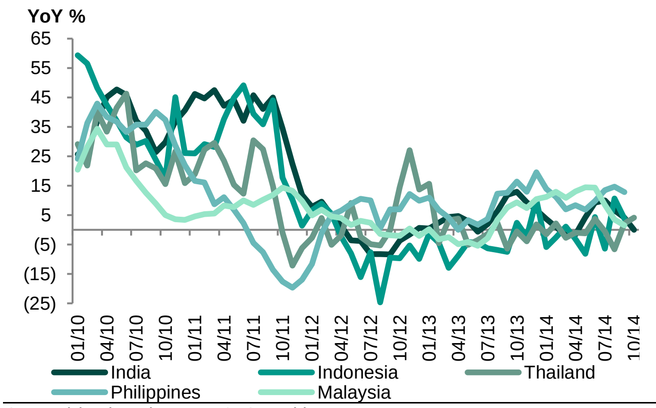
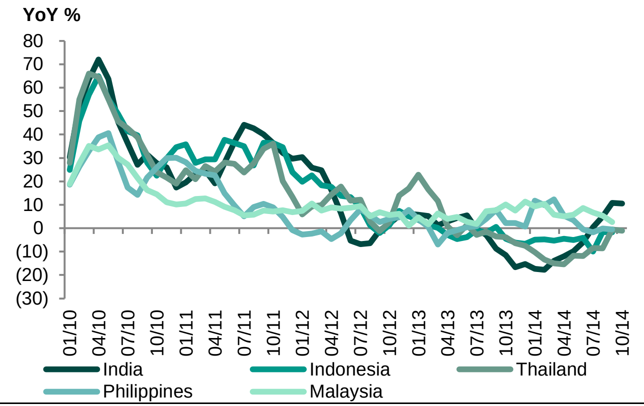


Exhibit 7: 3MMA import growth in Emerging Asia



Source(s): Bloomberg, ABCI Securities

Exhibit 8:Trade balance in 3Q13 in Emerging Asia

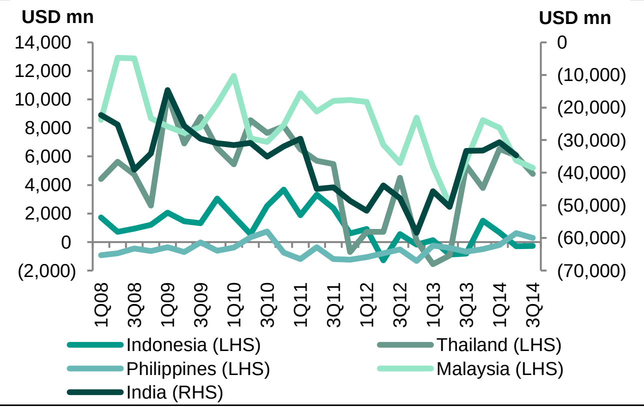
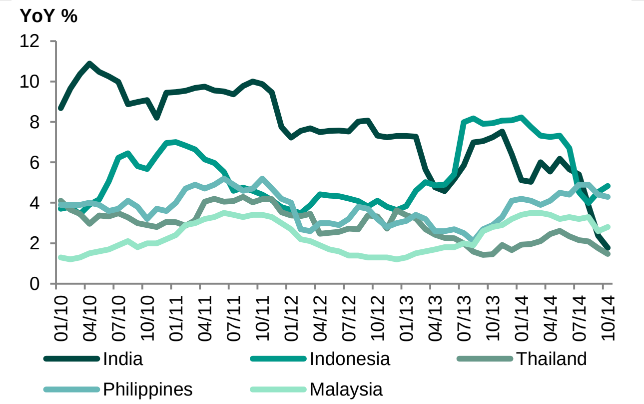


Exhibit 9: Inflation in Emerging Asia



Note: For Exhibit 10, India's inflation data is based on WPI, others are CPI
Source(s): Bloomberg, ABCI Securities

Exhibit 10: Government deficit in India and Indonesia

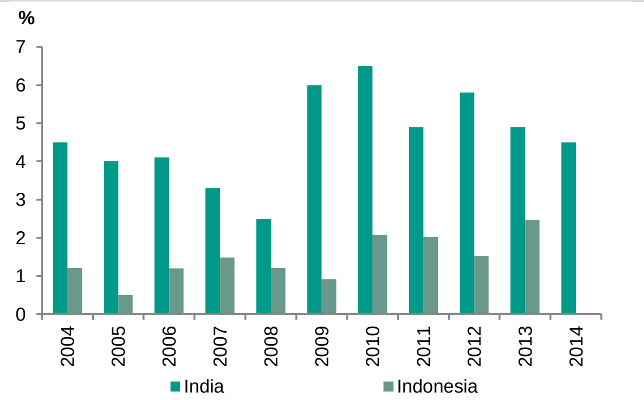
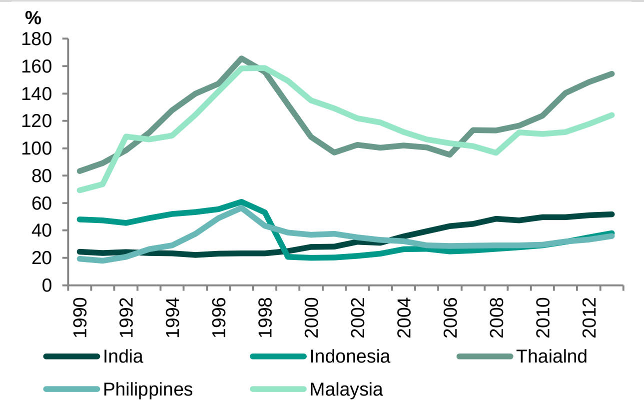


Exhibit 11: World Bank domestic private sector credit/GDP



Note: India's fiscal year ends on Mar 31
Source(s): Bloomberg, World Bank, ABCI Securities

China: Revitalizing growth momentum

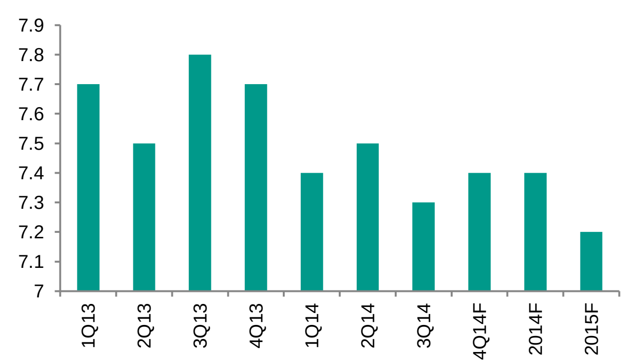
- A combination of accommodative monetary and expansionary fiscal policies will promote more consumption-led growth
- We expect PBOC will roll out further interest rate reduction (two rate cuts with 25bp each) and overall RRR cut (two 50 bp RRR) to stimulate economic activities
- Stimulus measures will help sustain consumption and investment. Hence, we expect China's GDP growth to reach 7.2% for 2015F

Revitalizing growth momentum

For China, the year of 2014 is marked by high global volatility and slowdown in economic activities. Nonetheless, we believe a brighter path is ahead as the government accelerates reforms for more balanced and sustainable growth. Better urbanization, improving investment efficiency through more high value-added investments, rebalancing economy toward consumption through boosting household income and lowering income disparity, and liberalizing capital markets become the key growth engines to sustain future economic growth. To offset the cyclical downturn in the economy, the government implements targeted stimulus measures, which include monetary easing through interest rate cut and a mix of targeted lending facilities, as well as fiscal expansion through infrastructure investment and tax reforms to boost domestic demand. Although adjustments in economic structure and the "new norm" of slower economic growth have caused short-term economic turmoil, China is committed to pursuing fiscal reform, SOE reform, along with financial and capital market reform to direct the economy toward a more sustainable path. We believe economic growth has already bottomed out in 3Q14; resurgence in investor confidence and growth momentum will emerge in 4Q14 and 2015.

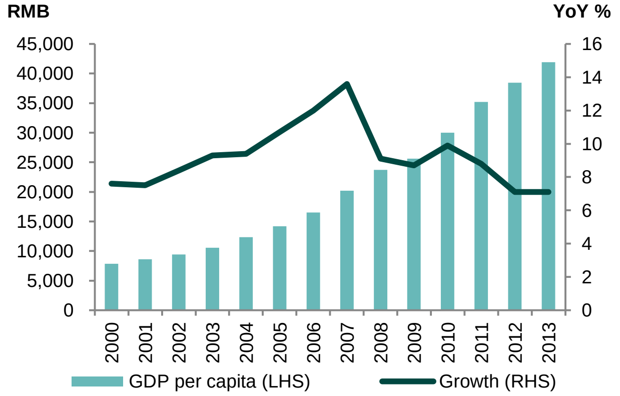
The year of 2015 will be characterized by recovery in the U.S., protracted stagnation in Eurozone and Japan, as well as continued economic rebalancing in China. Subdued growth in the global economy is expected for 1H15. The end of U.S.'s QE program will reduce liquidity directed to the emerging economies, hence suppressing economic momentum in the latter. In China, during the fourth plenary session of the 18th Central Committee of the Communist Party of China (CPC) held in October, Chinese President Xi Jinping called for promotion of the rule of law and comprehensively deepening reforms. We believe the strength of reforms will increase in 2015, with policies gearing toward enhancing domestic consumption to compensate for a downshift in investment. To stabilize economic conditions, policy easing becomes necessary and this has been reflected by PBOC's recent interest rate cut. The direction of a 'moderately loose' monetary policy implies abundant liquidity in 2015. Infrastructure investment will continue to grow at a relatively fast pace. Policy will turn more positive in tone, with greater emphasis being placed on stimulating aggregate demand. A combination of accommodative monetary and expansionary fiscal policies will promote more consumption-led growth. China's economy is expected to gather momentum, and forward-looking economic indicators will point to a modest acceleration in domestic demand. Stimulus measures will also help sustain consumption and investment. Hence, we expect China's GDP growth to reach 7.2% YoY for 2015F.

Exhibit 1: China's economic growth



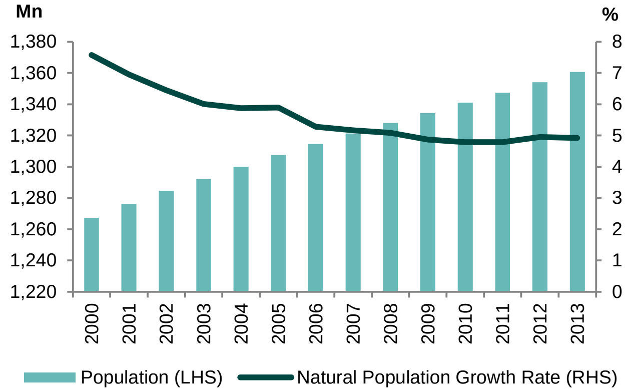
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 2: Wealth surges in China



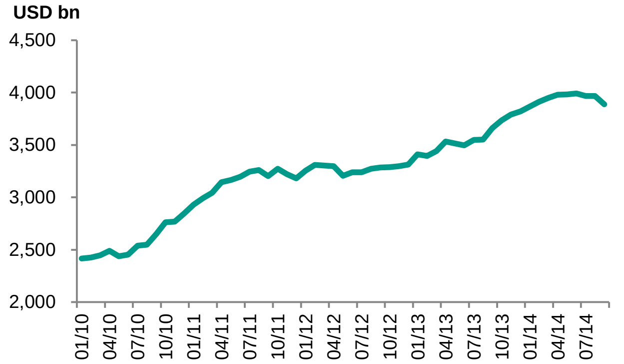
Source(s): Wind, ABCI Securities

Exhibit 3: China Population



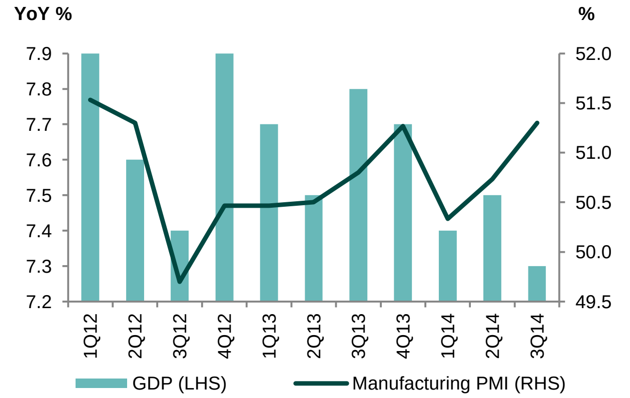
Source(s): Wind, ABCI Securities

Exhibit 4: Foreign reserves in China



Source(s): Wind, ABCI Securities

Exhibit 5: China's PMI vs. GDP



Source(s): Bloomberg, ABCI Securities

Exhibit 6: Economic forecasts for China

YoY % (otherwise specified)	2012	2013	1Q14	2Q14	3Q14	2014F	2015F
Real GDP	7.7	7.7	7.4	7.5	7.3	7.4	7.2
FAI (YTD)	20.6	19.6	17.6	17.2	16.1	16.0	16.0
Retail Sales	14.3	13.1	12.0	12.4	11.9	12.4	13.0
Exports	7.9	7.9	(3.4)	4.9	12.9	5.5	7.5
Imports	4.3	7.3	1.6	1.5	1.3	0.3	4.5
Trade Surplus (US$ bn)	231.1	259.8	16.6	85.9	128.1	375.3	462.1
CPI	2.6	2.6	2.3	2.2	2.2	2.0	2.6
PPI	(1.7)	(1.9)	(2.0)	(1.5)	(1.3)	(1.8)	0.5
M2	13.8	13.6	12.1	14.7	12.9	13.0	13.0
1-year deposit rate	3.00	3.00	3.00	3.00	3.00	2.75	2.25
1-year lending rate	6.00	6.00	6.00	6.00	6.00	5.60	5.10
Deposit RRR	20.0	20.0	20.0	20.0	20.0	20.0	19.0
Exchange Rate (USD/RMB)	6.2306	6.0543	6.2171	6.2031	6.1394	6.1000	6.0000

Source(s): Bloomberg, National Bureau of Statistics, PBOC, ABCI Securities estimates

China policy outlook for 2015

In accordance with China's economic growth and structural adjustment objectives, we estimate the central government will maintain a policy characterized by 'moderately loose' monetary easing and aggressive fiscal expansion. PBOC will continue to conduct expansionary monetary policy through reduction of interest rate and reserve requirement ratio (RRR), along with a mix of targeted lending facilities to support economic recovery while keeping inflation in the range of 2.5%-3%. Meanwhile, both the central and local governments will roll out more supportive fiscal policies, boosting investment and development in infrastructure and new strategic industrial sectors. Regional and rural infrastructure, investment in utilities, and subsidized housing construction will continue to be supported by government funding and bank lending. In sum, China will continue to fine-tune the current accommodative macroeconomic policies to sustain growth in 2015.

1. Monetary policy: a 'moderately loose' stance with accommodative liquidity management

Monetary policy in 2015 will focus on maintaining a moderately loose liquidity in 2015 as PBOC prioritizes to revive economic momentum, reform its daily macroeconomic management and improve efficiency of the financial market. Besides from optimizing financing and credit structures, major tasks of PBOC will also include maintaining money supply and total social financing (TSF) growth at a reasonable pace. Although the U.S. started to unwind its QE program in Oct and is poised to kick start the interest rate hike cycle in the near future, broader credit loosening measures by Japan and Eurozone are complicating the trajectory of global liquidity flow. In our view, monetary policy in China will remain expansionary to accommodate the market demand for liquidity. PBOC is likely to inject sufficient liquidity through a variety of monetary tools. Accordingly, we expect the annual new bank loans target will be set at RMB10.8tr -RMB 11.0tr for 2015F, compared to 2014's target of RMB 9.5tr. The target for M2 growth will be 13.0% YoY in 2015F.

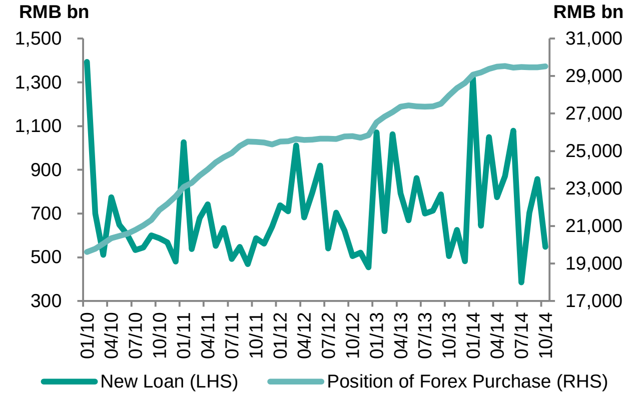
China will continue to adopt a wait-and-see approach for further credit loosening in 2015. Under a 'moderately loose' monetary stance, we expect PBOC will roll out further interest rate reduction (two rate cuts with 25 bp each) and overall RRR cut (two 50bp RRR) to stimulate economic activities. A mix of targeted lending facilities for monetary accommodation will continue to be conducted through repo, standing lending facility (SLF), short-term liquidity operation (SLO), mid-term lending facility (MLF), and pledged supplementary lending (PSL) to inject liquidity into the banking system. We may also see relaxation of loan-to-deposit ratio for commercial banks and additional widening of the deposit rate floating range through further interest rate liberalization and the launch of deposit insurance. In sum, both monetary easing measures and interest rate reforms will entail more flexibility to accommodate capital demand in 2015.

Exhibit 7: PBOC may set a lower inflation target for 2015

Year	Inflation target (%)	Actual inflation (%)	Over / Under the target	Monetary policy stance
2011	4.0	5.5	Over	Tightening
2012	3.0	2.7	Under	Prudent Liquidity Management
2013	3.5	2.6	Under	Prudent liquidity Management
2014F	3.5	2.0	Under	Prudent liquidity Management
2015F	3.0	2.6	Under	Moderately Loose

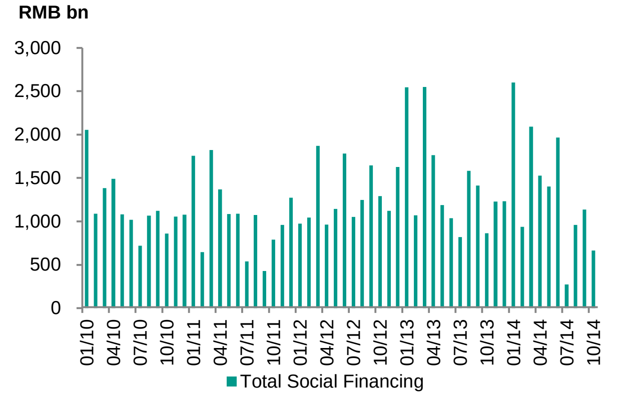
Source(s): State Council, National Bureau of Statistics, ABCI Securities estimates

Exhibit 8: China's liquidity growth driven by bank lending and capital inflow



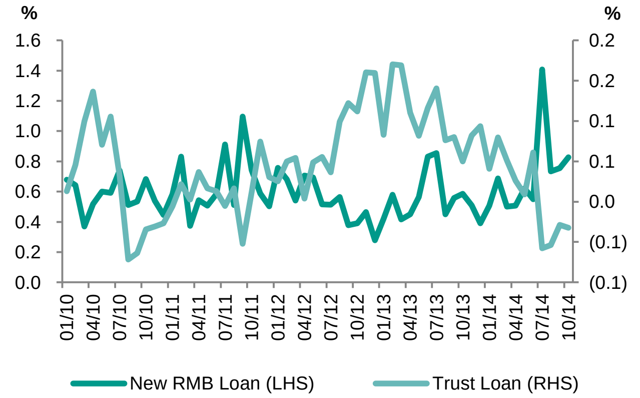
Source(s): Bloomberg, ABCI Securities

Exhibit 9: Total social financing turns stable in 2014 in China



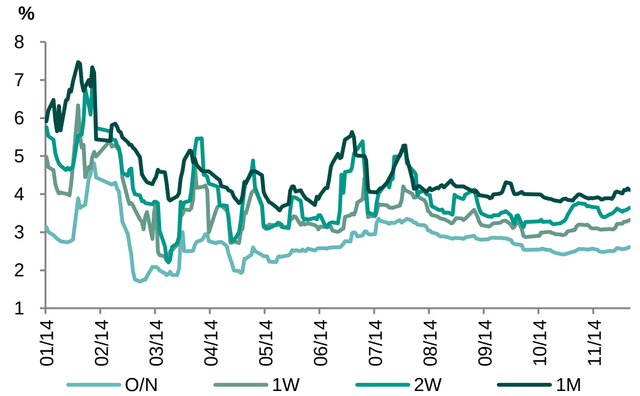
Source(s): Bloomberg, ABCI Securities

Exhibit 10: Share of new loans in total social financing has been stable while share of trust loans is diminishing in China



Source(s): Bloomberg, ABCI Securities

Exhibit 11: SHIBOR maintains stable trend, reflecting a prudent monetary stance



Source(s): shibor.org, ABCI Securities

2. Fiscal policy: deepening fiscal and tax reforms to boost growth

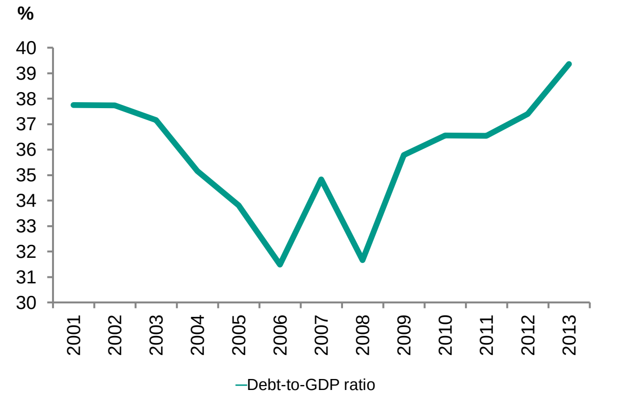
Fiscal policy remains expansionary in the sense that more fiscal and tax reforms will be launched to help transform the economy. Fiscal reform has been at the top of China's reform agenda. The task of clarifying taxation and spending responsibilities for the central and local governments are considered to be the most essential because this will ensure fair distribution of tax income and provide funding for social securities. Key aspects of reform include building a transparent budget management system and fine-tuning the tax structure. China is expected to achieve major fiscal reform targets by 2016 and the formation of a modern fiscal system will be completed by 2020.The reforms will focus on (1) developing a proper fiscal relationship between central and local governments; (2) setting up proper local tax systems; (3) cutting tax burdens for enterprises and households. Six taxes will be reformed to establish a unified and fair fiscal system. The taxes include: (1) the value-added tax (VAT); (2) consumption tax; (3) resources tax; (4) environmental tax; (5) property tax and (6) individual income tax. Following the regional pilot programs since early 2012, VAT reform has been expanded to railway transportation, postal services and telecommunication sectors. Such reform has reduced enterprises' tax burden by as much as RMB 328 billion since 2012, and will gradually expand to construction, property and financial sectors. VAT is expected to completely replace turnover tax by 2015.

The central government may also share revenue from consumption tax with local governments. Currently, consumption tax on luxury products and high net worth individuals is directed only to the central government. By sharing the revenue, local governments will enjoy an additional stream of tax income to compensate for the reduced income resulting from VAT reform. Property tax is expected to come into force to create additional tax income for local governments and reduce their dependence on land sales, which is commonly attributed as the leading cause of surging home prices.

The central government will continue to adopt an expansionary fiscal policy to boost FAI investment. Such a move would be consistent with its objective of transforming the nation's industrial structure over the medium term. In our view, the central government will support infrastructure investment in highways and railway construction, electricity grid upgrades, resource development in the central and western provinces, and agricultural reforms. Construction progress of subsidized housing, which is partly funded by local governments, will be closely monitored. In addition to establishing salary and social welfare adjustment mechanisms linked to economic growth and CPI movement, we also expect the government to address income disparity by providing more subsidies and raising average income for low-income communities.

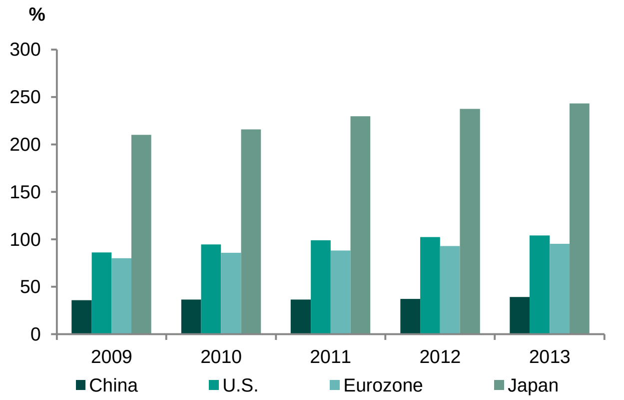
Fiscal stimulus will remain intact in 2015. To facilitate economic recovery, we expect more stimulus packages to be launched, which include: (1) expedited approvals for infrastructure and construction projects; (2) additional subsidies on energy-efficient consumer products; (3) encouraging private capital to flow into large, high-barrier industrial sectors previously dominated by state firms; (4) tax reform to support the services sector.

Exhibit 12: A healthy fiscal position to support reforms in China



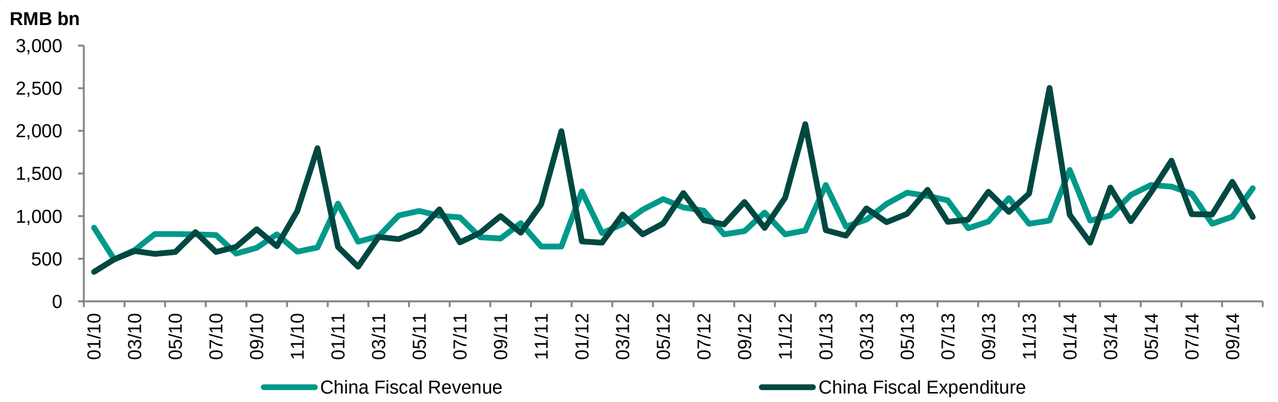
Source(s): Bloomberg, ABCI Securities

Exhibit 13: China's debt-to-GDP ratio is the lowest among the developed nations



Source(s): Bloomberg, ABCI Securities

Exhibit 14: Fiscal Revenue and Expenses



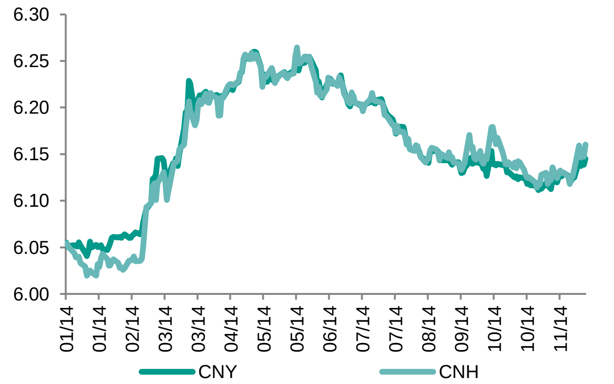
Source(s): Bloomberg, ABCI Securities

3. RMB to appreciate steadily in 2015; internationalization to accelerate

In 11M14, RMB depreciated by 1.5% on stronger USD and weaker-than-expected Chinese economy. The currency fell 2.5% in 1H14 but rebounded slightly in 4Q14 after economic activities in 3Q14 had bottomed out. It is likely that RMB will depreciate by 0.8% by end-2014.

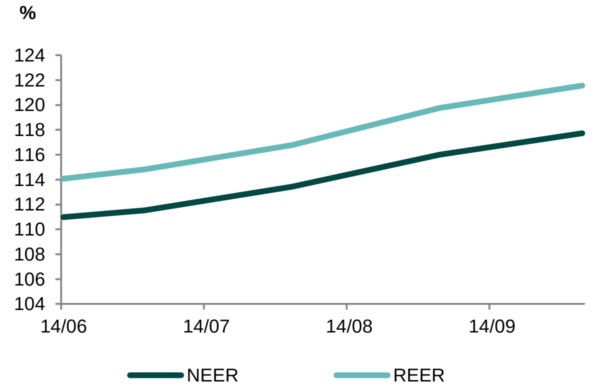
In 2015, the PBOC will further gear up forex liberalization by further widening the trading band of the RMB against the USD, increasing direct RMB trade with foreign currencies and facilitating development of more offshore RMB centers. Growth recovery in China is likely to support the value of RMB. Hence, we expect a 1%-2% appreciation for the currency for 2015F.

Exhibit 15: RMB moves down by 1.5% on higher volatility in 2014



Source(s):, Bloomberg, ABCI Securities

Exhibit 16: Nominal effective exchange rate and Real effective exchange rate have appreciated since June 2014



Source(s):, Bank of International Settlement ,ABCI Securities

China Economic Themes

1. Strengthening structural reforms to enhance investment efficiency

Aiming to transition China to a more free-market consumer economy with fewer social controls, China has unveiled its most sweeping reform agenda. China pledges to push ahead with a raft of market reforms to encourage more efficient capital allocation, increase foreign investment and improve market transparency. On the economic front, the plans include enhancing the operational efficiency of state-owned enterprises (SOEs), removing a swathe of price controls, phasing out caps on interest rates and moving toward fuller convertibility of RMB. Previously, state-dominated sectors such as finance, petrochemicals, aviation, coal, shipping, electricity, and even military industries will be opened up to private and foreign investors. Moreover, the reform calls for a “hybrid ownership structure” that combines state, private and other forms of ownership. It will transform state assets into “state capital” that will invest in enterprises in a manner similar to various sovereign funds in the global stock markets. In sum, the Chinese government has made great progresses in 2014 in promoting SOE reforms and normalizing cost via further liberalizing natural resources prices, interest rate, convertibility of exchange rate; developing multi-tier capital market structure; and liberalizing the capital account.

The current growth model is best known for the combination of rapid economic expansion and serious structural imbalance. Going forward, successful implementation of structural reforms will help set China’s growth model off on a more normalized and sustainable course. The government will continue to play an active role, but only to provide public goods and overcome market failure. Overall, the new reform agenda will likely serve as the last push needed to complete China’s transition to a market economy.

Exhibit 17: Structural reform initiatives

#	Reform initiatives
1)	Accelerate RMB convertibility and interest rate reform
2)	Push pricing reform for oil, gas, power, water, transportation, telecom & other sectors
3)	Allow local governments to expand financing channels for construction projects, including the issuance of bonds
4)	Set up free-trade zones in more areas
5)	Improve treasury yield curves to reflect market supply and demand
6)	Improve treasury yield curves to reflect market supply and demand
7)	Push through legislation for a property tax and implement further reforms when appropriate
8)	Allow non-state involvement in government projects
9)	Pursue a “mixed ownership” economy in a proactive manner

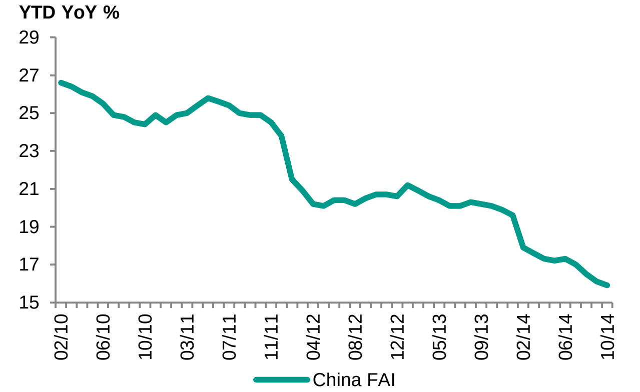
Source(s): ABCI Securities compilation

2. Value-added investment in fixed asset (FAI) to support growth

As China is transitioning to become a consumption-driven economy, it will have to rely more heavily on investment to stabilize growth. Slowdown of property development has further decelerated FAI growth to below 16% during the 10M14, the lowest in recent decades. We believe the central government is not keen to fully stimulate property market as it has repeatedly emphasized its determination to curb rising property prices. With private property out-of-bounds as an investment target, the only options left for large-scale government investment are infrastructure, social security housing and services. The data we have examined indicates FAI growth in these sectors has been rebounding since 3Q14. Thus, more investment in high value-added FAI projects may have an increasing impact on growth and we expect the momentum to sustain in 1H15.

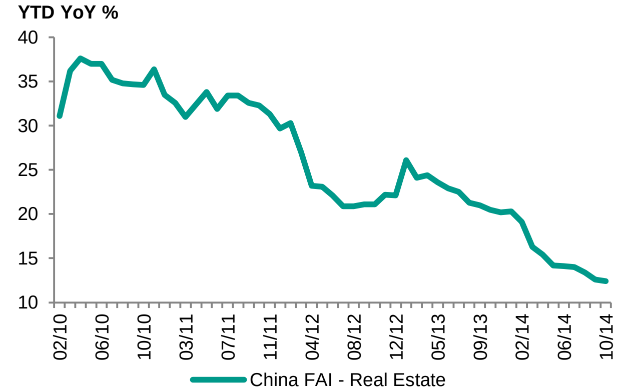
By sector, infrastructure, social security housing and services are likely to remain as key drivers. The theme of enhancing ‘urbanization’ increases demand for infrastructure investment, with local governments leading the charge to implement new rounds of stimulus in local infrastructure and manufacturing. Supported by projects in the 12th FYP, social security housing investment will surge in 2015 as several millions units are planned to be constructed. Services investment such as healthcare will return to above-trend growth. Manufacturing is on a secular slowdown, although the situation is likely to stabilize in 2015. Over the next few quarters, FAI in manufacturing may decelerate due to excess capacity and an already high base, while property FAI continues to trend down on the subdued property market. FAI in infrastructure and services may continue to outperform on strong demand. The government is likely to maintain the YTD FAI at 16% in 2015 to support economic growth.

Exhibit 18: FAI growth moderates on slowing property development



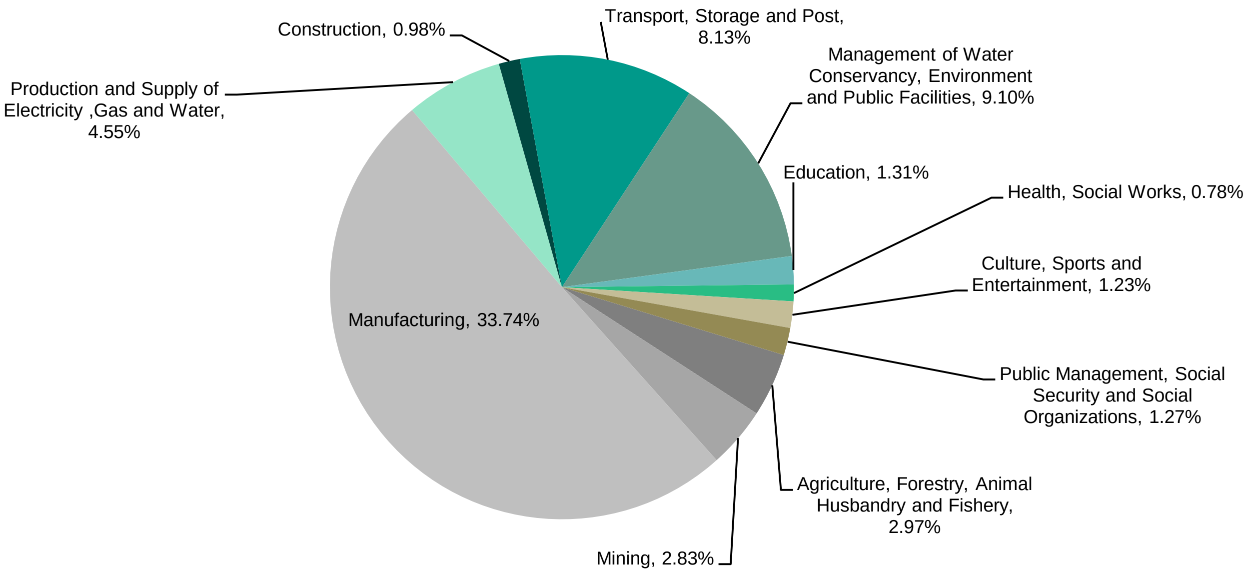
Source(s): Bloomberg, ABCI Securities

Exhibit 19: FAI growth in real estate market



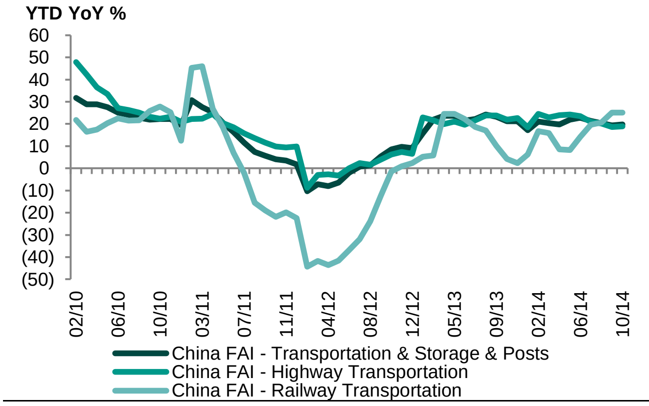
Source(s): Bloomberg, ABCI Securities

Exhibit 20: FAI breakdown by sector (as of Oct 2014)



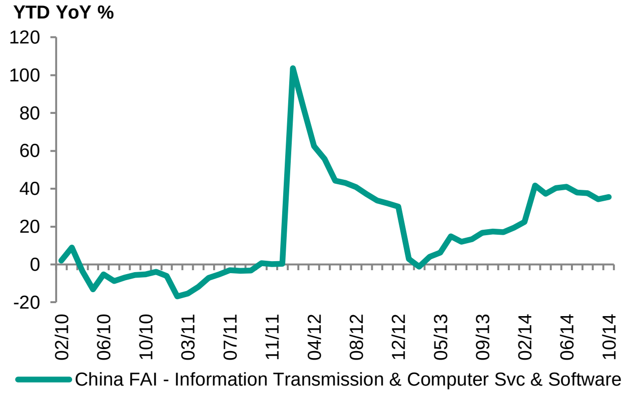
Source(s): NBS, ABCI Securities

Exhibit 21: Infrastructure FAI outperforms



Source(s): Bloomberg, ABCI Securities

Exhibit 22: Information-related FAI surges

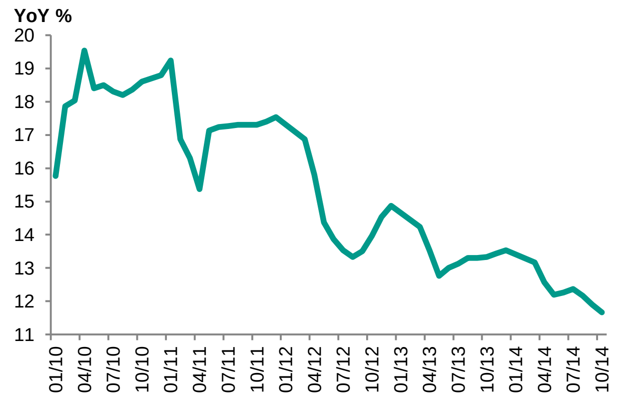


Source(s): Bloomberg, ABCI Securities

3. Sharp rises in services consumption

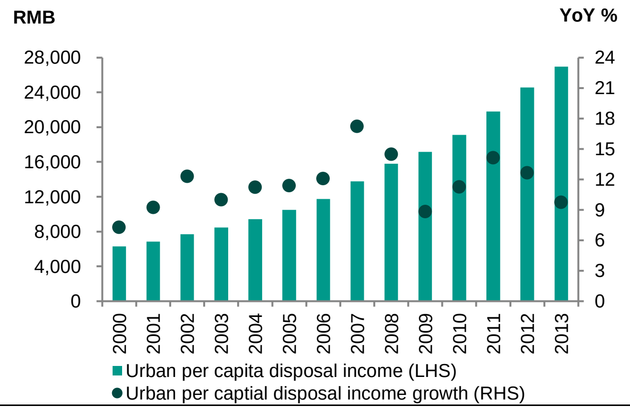
10M retail sales expanded only by 12% YoY, reflecting that higher consumption growth will be needed to support economic growth. China's State Council has recently announced pro-consumption policies in 6 areas including property, e-commerce, environment-friendly products and tourism. Aiming at the diverse needs of the masses and innovation, these measures mobilize market forces to increase effective supply, promote expansion and upgrade of consumption, and develop new industries. We believe services consumption will be a new driver in the medium term. Along with sustainable growth in residential disposable income and average household wealth, we believe that services consumption, primarily consumer spending on medical services, education, entertainment, tourism, household services and financial services, will act as the main forces to drive urban consumption growth.

Exhibit 23: 3MMA retail sales growth is stabilizing



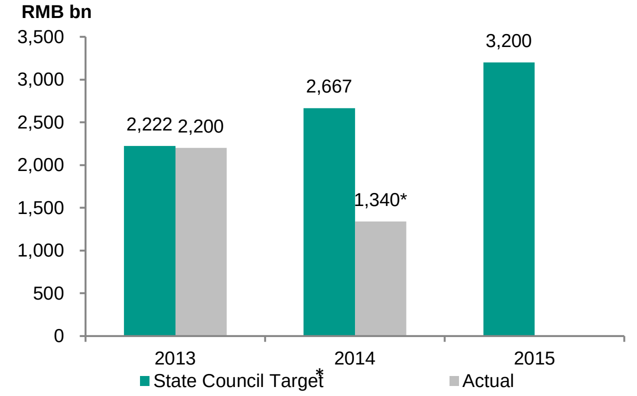
Source(s): Bloomberg, ABCI Securities

Exhibit 24: Stable growth of personal disposable income of urban household



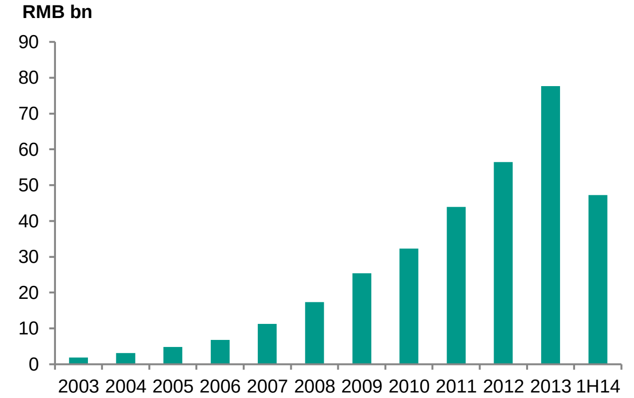
Source(s): Wind, ABCI Securities

Exhibit 25: Information consumption in China



Notes:
* State Council Target is calculated based on an assumed 20% YoY growth
** 1H14 figure
Source(s): MIIT, PRC State Council, ABCI Securities

Exhibit 26: Online gaming revenue in China



Source(s): China Internet Network Information Center, ABCI Securities

Exhibit 27: Six areas of focus on promoting consumption

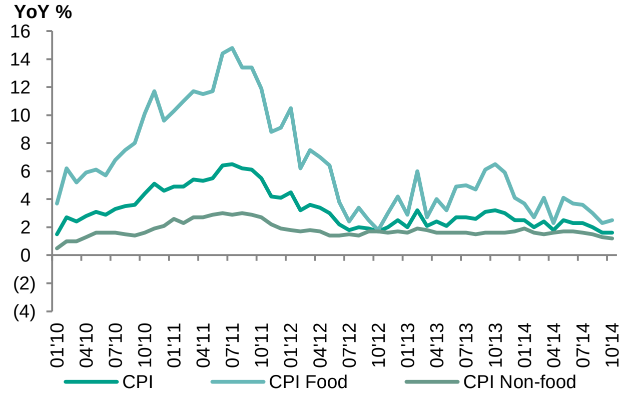
#	Areas of focus
1	Boost information consumption such as mobile internet and IOT (Internet of Things) by increasing broadband speed and development of online shopping and e-commerce distribution in rural areas; promote applications of big data in areas such as health and medical care, and corporate supervision
2	Encourage green consumption by promoting the use of energy-saving products and providing incentives for construction of large-scale facilities for new energy vehicles
3	Stabilize housing consumption by increasing supplies of low-income housing; relax the criteria for withdrawing contributions from housing provident funds for rental payment
4	Upgrade Travel and leisure consumption by introducing the paid leave system for employees; promote rural travel and construct drive-in and recreational vehicle campgrounds
5	Promote education, cultural and sports consumption by improving the fee collection policy for private schools and increase cooperation between Chinese and foreign institutions in running schools
6	Encourage consumption of pension, health, and housekeeping; explore the possibility of setting up industry funds for the development of elderly services; formulate taxation policies to encourage private capital to invest in such services; match utility charges of private medical institutions with public ones

Source(s): The State Council , ABCI Securities

4. Softening inflation in 2015

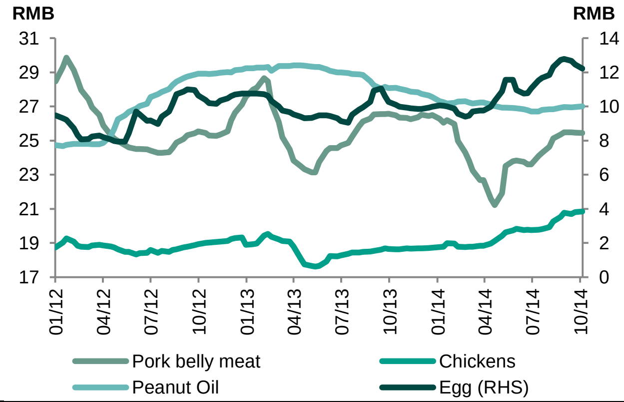
For 10M14, CPI inflation fluctuated between 1.5% and 2.5%, with the YTD CPI inflation reaching 2.1%. Mild CPI inflation against the government target at 3.5% during the period was caused by the economic slowdown, base effect and weakening price inflation of agricultural products. We believe that surging liquidity triggered by a mix of monetary easing measures, including the rate cut, RRR cut, and targeted easing measures, will enhance pricing pressure. We expect CPI will rise to 2.6% YoY in 2015F and the overall price inflation will fluctuate in the range of 2.3%-2.7% YoY. China's PPI has been declining since Mar 2012 on moderating international commodity prices and weakening domestic demand. Based on the lukewarm global outlook, a major inflation of international commodity prices is unlikely in the near term. Meanwhile, growth in China's FAI and industrial production will remain stable, and domestic industrial goods prices will not see major rebounds. Therefore, we forecast PPI to edge up by 0.5% YoY in 2015F.

Exhibit 28: China CPI trends down on moderating food prices



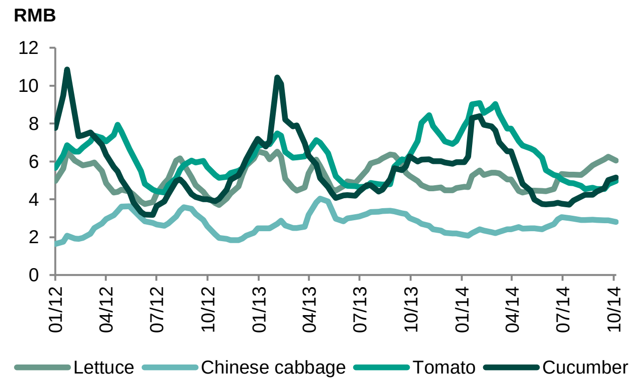
Source(s): Bloomberg, ABCI Securities

Exhibit 29: China 50-cities average prices of selected agricultural produces in 2014 – Meat



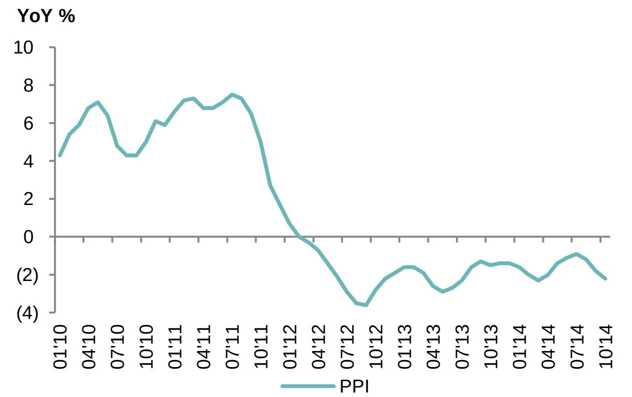
Source(s): Bloomberg, ABCI Securities

Exhibit 30: China 50-cities average prices of selected agricultural produces in 2014 – Vegetable



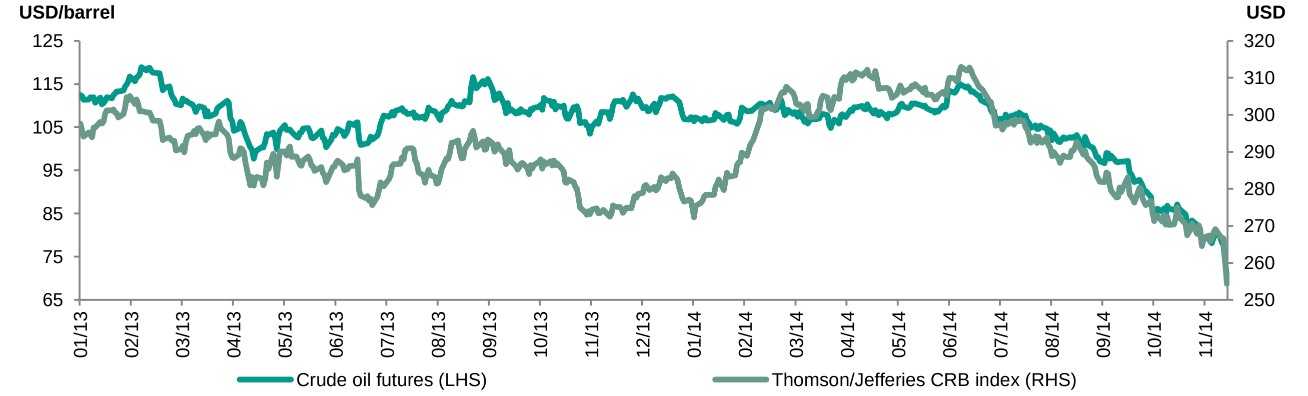
Source(s): Bloomberg, ABCI Securities

Exhibit 31: Lower production prices exert downward pressure on the CPI in China



Source(s): Bloomberg, ABCI Securities

Exhibit 32: Falling international commodity prices in 2014



Source(s): Bloomberg, ABCI Securities

5. Moderated external trade recovery

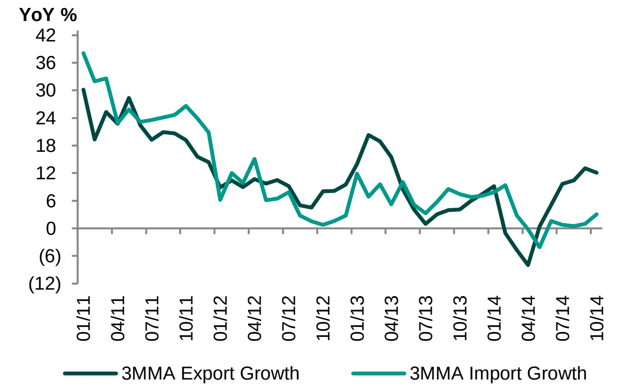
Although strong demand from the U.S. and ASEAN countries is able to partially offset the stagnation in Europe and Japan, global trade outlook remains uncertain. We expect China's exports to maintain a healthy growth on demand recovery from developed nations. The aggregate export growth is expected to be 7.5% YoY for 2015F.

Key economic indicators in the U.S. suggest that its economy is expanding. The recovery has been largely attributed to recovery of consumer confidence and property market and decline in unemployment. Based on the improving outlook, we expect China's exports to the U.S. will attain a double-digit growth at 12.5% YoY for 2015F. In addition, China's trade with EU, Japan and ASEAN countries has remained stable in 2014. With Japan's new QE pledge and EU's monetary easing, we expect trade between China and its major partners will improve gradually in 2015.

China’s imports remain weak for the most part of 2014 amid tepid domestic demand and fallen commodity prices. In our view, the lower import prices resulted from deflating commodity prices would spur consumption demand.

China is now turning its focus to increase imports. To achieve such goal, the government may opt for preferential charging policies, scrutinizing import charges while encouraging domestic corporates to participate in import-related businesses. Enterprises can also make use of the better hi-tech equipment imported from the developed countries to upgrade their industrial structures. All these policies would provide support to domestic demand and strengthen economic rebalancing in China. Hence, we expect the country’s import growth to accelerate to 4.5% YoY for 2015F.

Exhibit 33: Growth momentum of external trade stabilized (3MA Exports and Imports)

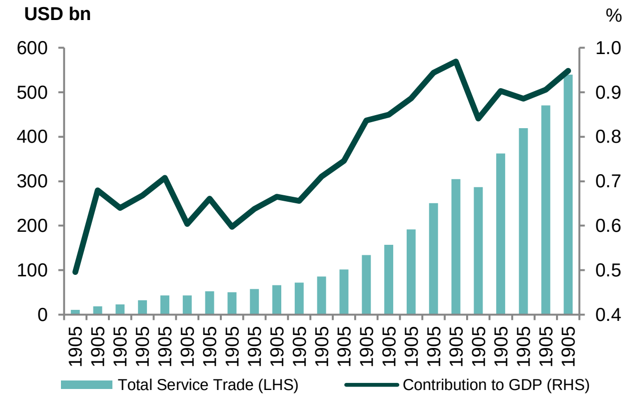


Source(s): Bloomberg, ABCI Securities

Exhibit 34: Trade balance is widening in China

Source(s): Bloomberg, ABCI Securities

Exhibit 35: Services trade is expanding rapidly in China



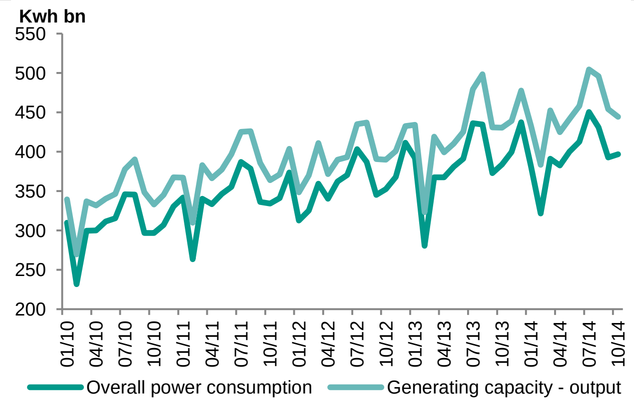
Source(s): Wind, ABCI Securities

6. Growing preference on renewable energy

China is faced with the daunting tasks of maintaining a sustainable economic growth. Thus, it becomes crucial for the Chinese government to maintain sustainable and sensible uses of energy resources. China's energy development must follow a path featuring high-tech content, low resource consumption, less environmental pollution, satisfactory economic returns, and high security. The objective of an economical, clean and secure development will be the future direction for energy.

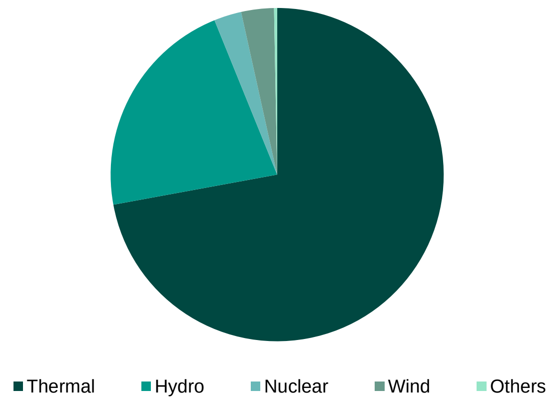
Amid rising awareness of environmental pollution, China's current reliance on fossil fuels will be reduced by increasing use of clean and renewable energy. As the reduction of national pollution has been prioritized in NPC this year, China will increase the share of non-fossil fuels in its overall energy consumption. With the implementation of more supportive policies to boost usage of non-fossil fuels, we expect strong capacity growth among clean energy providers in the nuclear, solar, and wind power sectors.

Exhibit 36: Electricity consumption moderates in 2014



Source(s): Wind, ABCI Securities

Exhibit 37: Breakdown of energy usage in China (as of Oct 2014)

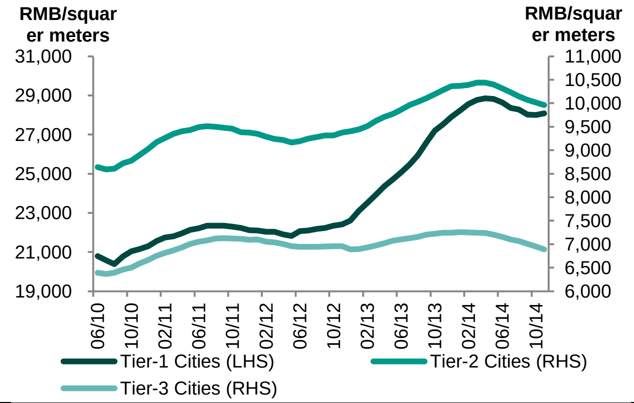


Source(s): Wind, ABCI Securities

7. Relaxation of property policy supported by rate cut in sight

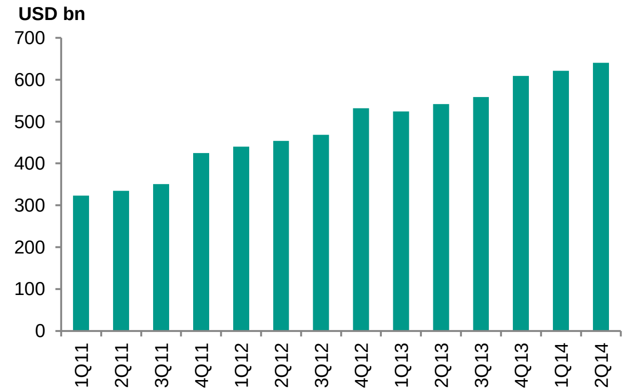
Moderating housing prices in China's property market has become a concern for the central government. The government's tightening measures to control prices in the domestic real-estate market lay more emphasis on promoting affordable housing for the poor, raising percentage of down payments for the first-home buyers while banning home loans for the multiple-home owners. Although these measures aim to engineer a soft landing for the property market, weakening property prices and investment slowdown in property development against the backdrop of a moderating economy have heightened risk of a hard landing. To boost sentiment and transaction volume, local governments and banks took steps to loosen policies. We believe housing prices have already retreated to a more affordable level; policymakers are likely to remove restrictive measures and reduce financial burden through rate cuts that may have excessively weighed on the housing market, and market demand will return on further policy relaxation. For 2015F, we expect overall residential property prices will achieve a healthy single-digit growth.

Exhibit 38: China 100-city property price index



Source(s): Wind, ABCI Securities

Exhibit 39: Trade balance is widening in China



Source(s): Wind, ABCI Securities

8. Surging ODI to further liberalize capital account

China’s outward direct investment (ODI) expanded significantly in the past decades, with much of the investment being directed to the developing nations. ODI jumped 40-fold in just 12 years, and Chinese enterprises have become increasingly active in pursuing investments in overseas countries in recent years. In 2002, China's ODI reached US$ 2.7bn; in 2013, the figure soared to US$107.8bn. In 10M14, China's ODI reached US$ 81.88bn, up 17.8% YoY; China's FDI totaled US$ 95.8bn, down 1.2% YoY. ODI’s double-digit growth, compared with the single-digit decline in FDI for the same period, indicates that its scale is likely to exceed FDI in the future.

In recent years, the focus of Chinese investors has shifted to developed economies in North America, Europe and Japan. In 10M14, China’s YoY ODI growth in the U.S., Eurozone, and Japan increased sharply by 30.5%, 192.6% and 128.6%, respectively. As China’s economic wealth and sophistication increase, the composition of its ODI is becoming more diverse although much of investment is still concentrated in natural resources sector at present. In 2014, ODI grew rapidly in the manufacturing, construction and financial industries, while investment in mining sector declined.

Official policy initiatives are facilitating ODI flows. Specific targets and measures were announced in the 12th FYP in 2011, and more recently in the “Third Plenum” that highlighted deregulation and market liberalization to promote inward FDI and ODI. In addition, RMB internationalization is facilitating ODI growth. An increasing share of China’s ODI is RMB-denominated, and such flows are passing through Hong Kong given its role as an offshore RMB center. Furthermore, RMB internationalization and growing offshore RMB business opportunities are creating greater incentives for China’s domestic financial institutions to go global.

In sum, growing Chinese investment in developed economies will open up new opportunities. Currently, China still retains significant control on capital inflows, with many sectors of the economy (especially in services) remaining closed to foreign investment. The government stresses that it will open up more sectors for private and foreign investment in a gradual manner. We believe the growing interest to invest in developed economies will accelerate the pace of opening at home. This could lead to a more liberalized China and offer more opportunities for foreign multinationals to invest in industries currently off-limits to them.

9. SH-HK stock market connect: an important step for capital market liberalization

China unveiled the mutual market access program between Shanghai and Hong Kong stock exchanges on Apr 10, 2014. The program was subsequently launched on Nov 17, 2014. Such a move could accelerate China’s opening of its capital market, facilitate the financial market reform in the country, and introduce new investment opportunities for investors in both markets. The mutual stock market access aims to create bilateral access to the stock markets in PRC and Hong Kong, allowing foreign investors to participate in PRC’s A-share market and PRC investors to trade in the Hong Kong market. The unprecedented access to China’s RMB 26tr (US$ $4.2 tr) equity market is a milestone of China’s further liberalization of its capital account as well as its financial market reform.

Development of the offshore RMB market in Hong Kong will be expedited on increased access to the PRC stock market. Accounts established under the new scheme, and new China-directed investing services will spur demands for RMB and enhance transaction volume in both stock markets. More innovative financial products and services denominated in RMB will emerge, and Hong Kong’s position as the leading offshore RMB center will be elevated.

Hong Kong Economic Outlook 2015

Hong Kong's economy gained traction during 3Q14, posting a stronger-than-expected GDP growth of 2.7% YoY. Consumption rose 3.2% YoY, offsetting decline in investment and low single-digit growth in external trade. In 4Q14, escalation of ‘Occupy Central’ campaign has brought about negative economic impacts. We expect consumption growth to fall to 1.5% YoY for 4Q14F on declines in tourist spending and retail sale amid a concurrent slowdown in domestic demand. Hong Kong’s GDP growth will be low at 1.8% YoY for 4Q14F.

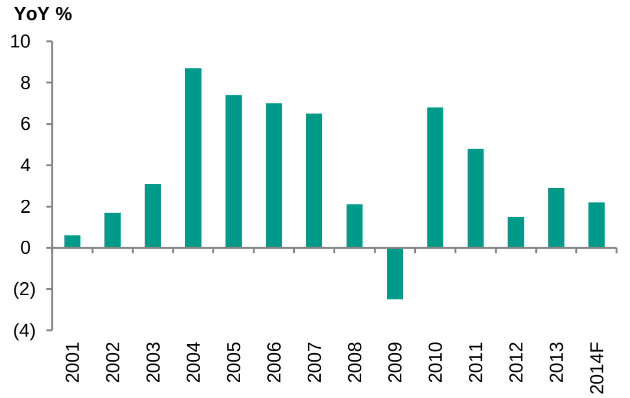
Hong Kong’s external trade sector remained a drag on growth as the U.S.’s QE exit may affect global trade. Meanwhile, tourist spending and demand for business services from mainland companies will continue to provide support to the domestic economy. Domestic fixed asset investment, especially infrastructure investment, will post negative YoY growth due to high-base effect. Key headwinds affecting the local economy include weakening momentum of retail sales, slowdown in property market, and continuous disturbance resulted from the ‘Occupy Central’ campaign. A mild expansion in Hong Kong’s economy can be expected, and our GDP growth forecasts for 2014F and 15F are 2.2% and 2.4%.

Exhibit 40: Economic forecasts for Hong Kong

Year	2011	2012	2013	2014F	2015F
Real GDP	4.8	1.5	2.9	2.2	2.4
Consumption	8.4	4.1	4.3	1.5	2.4
Investment	10.2	6.8	3.3	(2.3)	2.3
Government Consumption	2.5	3.6	2.3	2.8	2.5
Exports	3.9	1.9	6.4	1.8	2.9
Imports	4.6	2.9	6.8	1.4	2.8
Unemployment Rate	3.4	3.3	3.4	3.2	3.2
Inflation	5.3	4.1	4.3	4.4	4.1

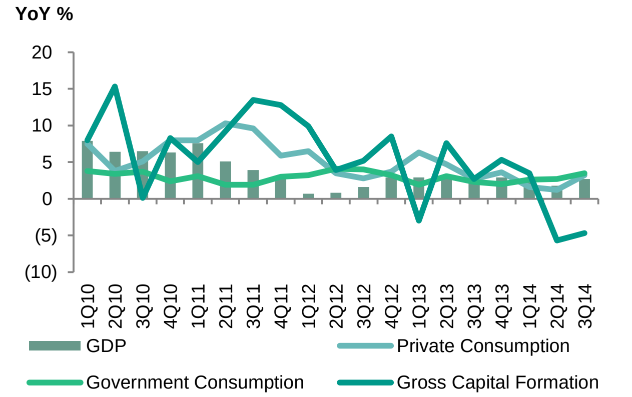
Source(s) :Bloomberg, ABCI Securities estimates

Exhibit 41: Hong Kong’s GDP growth forecast



Source(s): Bloomberg, ABCI Securities estimates

Exhibit 42: Hong Kong’s growth drivers

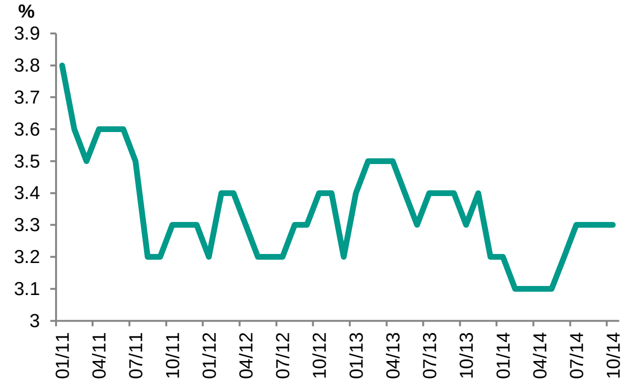


Source(s): Bloomberg, ABCI Securities

Exhibit 43: Hong Kong 's 3MMA export and import

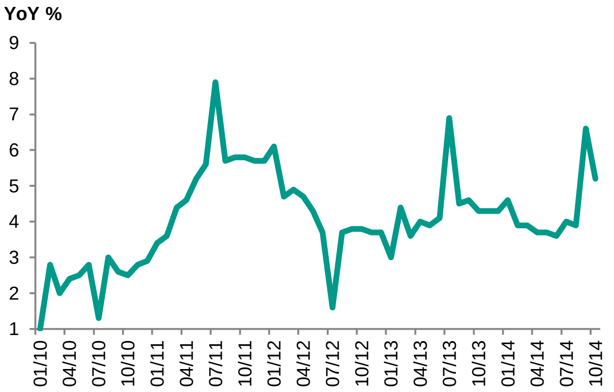
Source(s):, Bloomberg, ABCI Securities

Exhibit 44: Hong Kong unemployment rate stays low



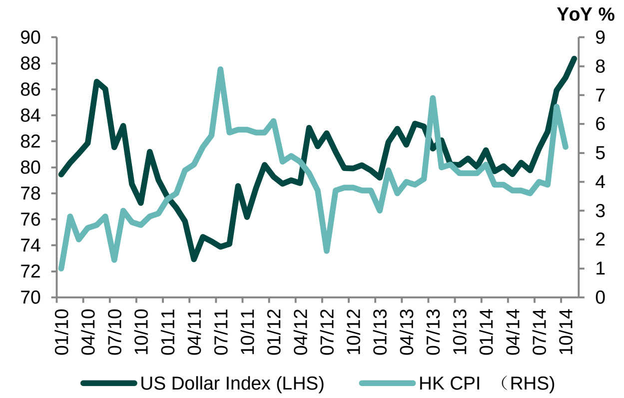
Source(s): Bloomberg, ABCI Securities

Exhibit 45: 10M14 CPI Hong Kong was above 4%



Source(s): Bloomberg, ABCI Securities

Exhibit 46: US Dollar index and Hong Kong inflation

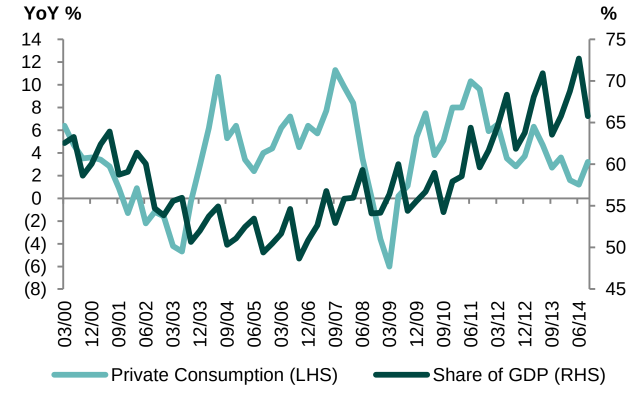


Source(s): Bloomberg, ABCI Securities

1. Falling tourists' visit and spending drag on retail sales

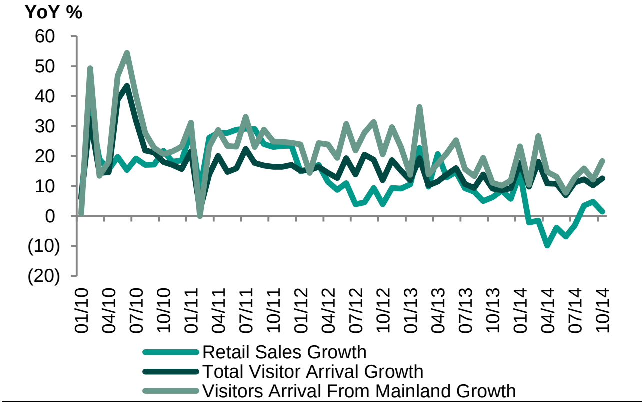
Growth in Hong Kong's economy lost steam as domestic demand weakened notably on the back of reduced tourist spending and a high comparison base last year. Increasing civil unrest caused by the "Occupy Central" campaign deters Chinese tourists from visiting, heaping further pressure on retailers which have been grappling with a protracted slowdown in sales. YTD growth of Chinese visitors reached 15.5% in Oct, slowing from 18.9% in 2013. YTD retail sales value dropped 0.2% YoY in Oct, indicating an overall contraction in tourist spending. With mainland visitors cutting back on luxury goods purchase, retail sales will continue to soften. A stable labor market and a buoyant asset market, which help support household income and keep consumer spending growth in positive territories, will help neutralize the decline in mainland tourist spending. Total employment remains strong, with the latest seasonally adjusted unemployment rate for Aug-Oct staying low at 3.3%. Retail sales are expected to be driven by local consumption, which will maintain a low single-digit growth in 2014F and 2015F.

Exhibit 47: Growth in private consumption expenditure remains resilient in 3Q14 but "Occupy Central" campaign will reduce consumption growth in 4Q14



Source(s): Bloomberg, ABCI Securities

Exhibit 48: Due to slowing visitor arrivals and a falling per capita spending, retail sales expansion moderated in Hong Kong

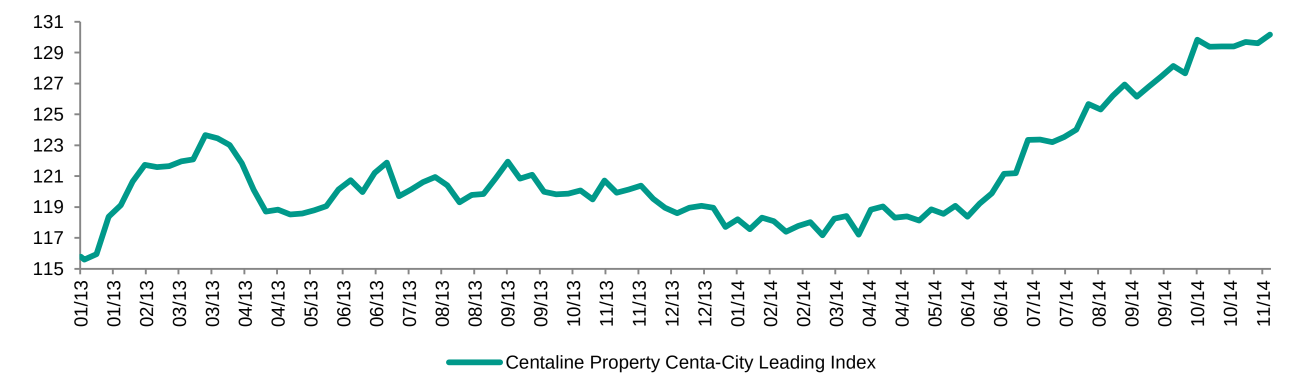


Source(s): Bloomberg, ABCI Securities

2. Property market's correction in sight amid the looming interest rate hikes

Tighter lending standards, mortgage restrictions, as well as higher levies and stamp duties have slowed the housing market unevenly in Hong Kong. Transaction volumes and prices of medium- and large-sized properties have declined, while those of small-sized properties still post a sharp increase on robust demand. However, a looming shift in global financial conditions will be an added challenge to the housing market. The U.S. is expected to begin lifting interest rates starting from mid-2015, at which point Hong Kong's rates will also rise. Higher rates add downside risk to the housing market and will pressure the already overstretched households. In addition to rising supply of private properties in 2015, we are likely to see a downward adjustment of property prices at 5%-10%.

Exhibit 49: Property price in Hong Kong surges unevenly in 2014

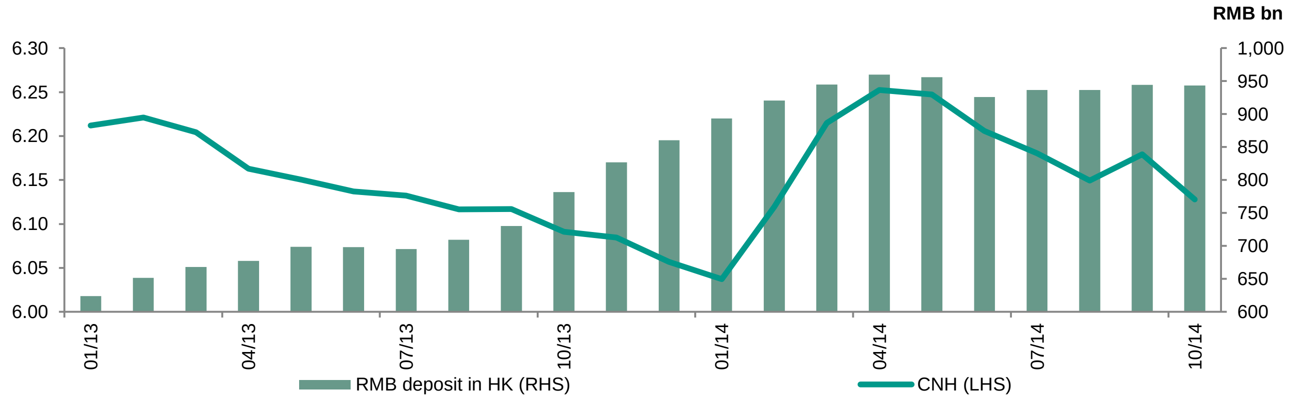


Source(s): Bloomberg, ABCI Securities

3. Hong Kong's role in the liberalization of China's capital account

With the launch of the SH-HK Stock Connect program, China opens up capital markets in connection with Hong Kong and unveils more plans to allow freer flows of capital in and out of China. Hong Kong, as China's RMB offshore center, plays a key role in liberalizing China's capital account. Launching the SH-HK stock connect program, removal of RMB conversion quota, widening the scope of QDII and QFII/RQFII, liberalizing interest rate, expanding trading band of RMB and strengthening financial sector reforms will facilitate the capital flow and promote the full convertibility of RMB. Hong Kong, as the premier offshore RMB financial platform for international investors, is poised to benefit.

Exhibit 50: CNH and RMB deposits in Hong Kong (L: RMB bn, R:RMB)



Source(s): Bloomberg, ABCI Securities

Investment Strategy for 2015

- We expect HSI and HSCEI to reach 26,568 and 13,152 at end-2015F
- China's interest rates are in a downward cycle; the lower systematic risk helps boost market valuation
- Highly-leveraged sectors such as property, public utilities, and infrastructure are set to benefit from lower borrowing costs
- Reform of SOE will reduce non-systematic risk and enhance valuation
- Interest rate liberalization will present challenges to commercial banks but provide opportunities for other players in capital market

Review of 2014 – Hang Seng Index (HSI)

The following factors have contributed to the flat earnings growth of HSI in 2014:

- Negative earnings growth in certain large-cap property and banking stocks in Hong Kong
- Negative earnings growth in large-cap energy resources stocks in China
- Weak earnings growth in China's banking, consumer, and telecom sectors, which offset gains in China's insurance, IT and casino sectors that showed upbeat earnings growth

Average profitability of the member stocks in HSI has been declining since 2012. We expect ROAE of HSI to fall to 12.4% for 2014F, down 0.9 ppt from 2013. The index was fluctuating in the range of 21,137.61-25,362.98 in 11M14, representing 9.80-11.76x 2014F P/E or 1.40-1.16x 2014F P/B. Although EPS growth has been moderating between 2012-14F, P/E band of the index has been trending up. The floor of P/E band was 8.6x/9.1x for 2012/13 and is expected to reach 9.8x for 2014F; the band's ceiling was 10.8x/11.2x in 2012/13 and is expected to reach 11.8x for 2014F. We believe the higher P/E band is a result of the declining systematic risk supported by recovery in the U.S. economy, monetary easing in Eurozone and Japan, and counter-cyclical monetary and fiscal policies in China.

The declining ROAE of HSI has been lowering the ceiling of P/B band, reaching 1.71x/1.45x/1.45x for 2011-13 and is expected to be 1.40x for 2014F. With ROAE exceeding 12% in 2012-14F, bargain hunters entered the market once the index P/B fell below 1.2x, resulting in a market rebound. Hence, the floor of P/B will stabilize at 1.15x-1.17x in 2012-14F.

Outlook for 2015 – HSI

Overall speaking, there are very few growth stocks in the index. We expect the constituent China's banking stocks to attain a 5%-8% EPS growth and constituent Hong Kong's banking stocks to register a 5%-10% EPS growth in 2015F. EPS growth of China's and Hong Kong 's property stocks will turn around, mainly due to low base in 2014 and counter-cyclical measures adopted in China's property market. Earnings growth in China's energy resources and consumer goods sectors will remain weak in 2015F. While earnings growth among IT, telecom and entertainment stocks will stay strong, although the YoY increase may slow on high base in 2014.

EPS of HSI is expected to increase 6.8% in 2015E; the index's ROAE will stabilize at 12.2%. Earnings growth for 2015F, in absolute terms, is excited compared with a virtually flat growth in 2012-14F. However, this projected growth is largely based on our assumption that business environment of sectors experiencing a cyclical downturn in 2014 (property, banking and energy resources) will stabilize in 2015.

Dividend payout will be at ~ 40%. However, the floor of the index's dividend yield band will be lifted. We anticipate the rate hike cycle in the U.S. to occur within the next 12 months. The increase in interest rates will undoubtedly create downward pressure to the index's dividends as corporates prefer to retain cash as interest rate rises. Hence, dividend payout ratio is unlikely to increase but floor of the dividend yield band will rise as risk-free rate increases.

P/B band of HSI remains in narrow horizontal channel on stabilizing ROAE. With an ROAE of 12.2% for 2015F, we anticipate the index will find support at 1.16x-1.17x P/B. However, the ceiling of P/B band will be capped at below 1.42x on the high single-digit earnings growth.

Combining the P/E, P/B and dividend yield valuations, we forecast the trading range of HSI for 2015F to be 22,744-27,252, representing a P/E band of 9.88x-11.84x, a P/B band of 1.16x-1.39x, and a yield band of 3.33%-3.99%. We set our end-2015E target for HSI at 26,568, representing a forward P/E of 11.54x, a P/B of 1.35x , and a yield of 3.41%.

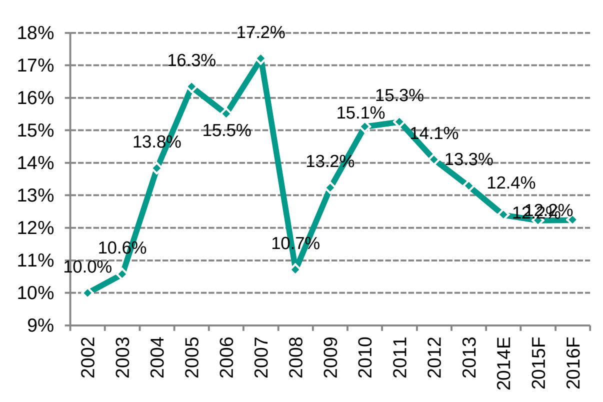
Exhibit 1: Projected trading range of HSI in 2015

Method	Valuation band range in 2015E			Corresponding HSI trading range		
1	P/B high	P/B low	End-2015F	**Index high**	**Index low**	**End-2015F**
	1.42	1.16	1.40	27,849	22,821	27,457
2	P/E high	P/E low	End-2015F			
	12.00	10.00	11.60	27,617	23,014	26,696
3	Yield low	Yield high	End-2015F			
	3.45%	4.05%	3.55%	26,291	22,396	25,550

Average	**27,252**	**22,744**	**26,568**
Implied '15 P/E	11.84	9.88	11.54
Implied '15 P/B	1.39	1.16	1.35
Implied '15 yield	3.33%	3.99%	3.41%

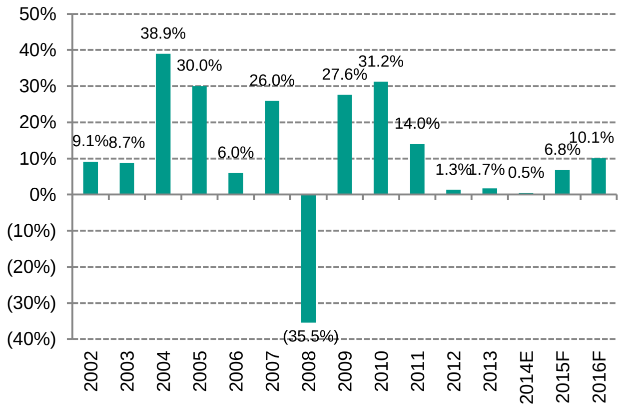
Source(s): ABCI Securities estimates

Exhibit 2 : HSI's ROAE in 2002-16F



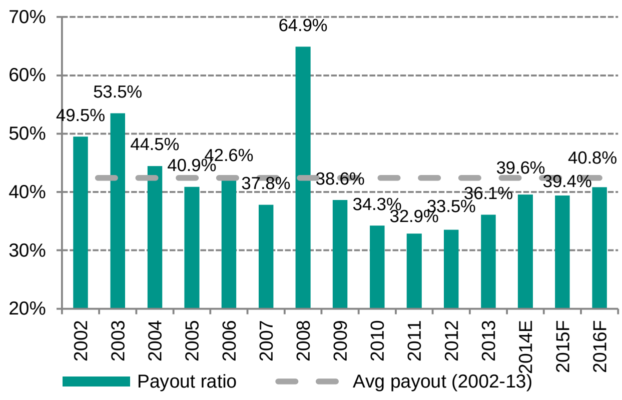
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 3 : HSI's EPS growth in 2002-16F



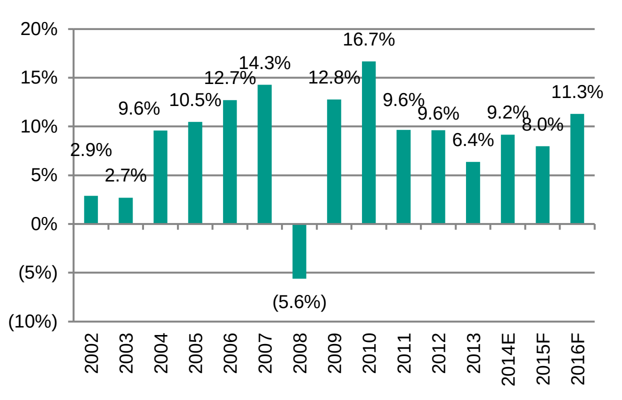
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 4: HSI's dividend payout ratio in 2002-16F



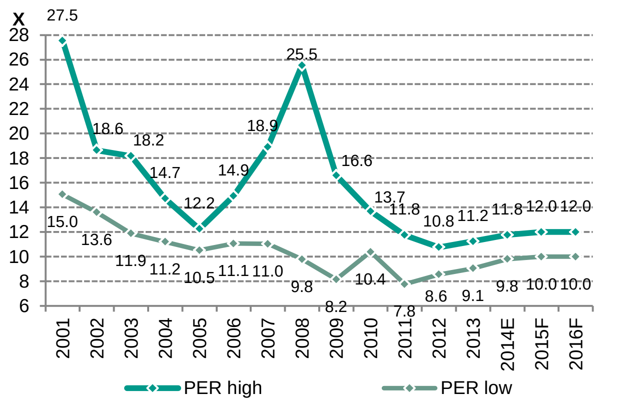
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 5: HSI's NBV growth in 2002-16F



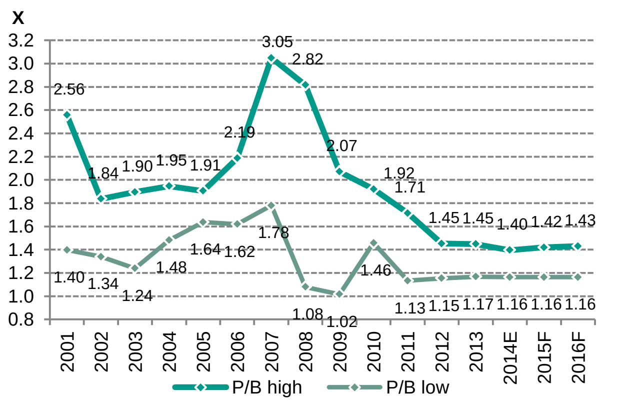
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 6: HSI's P/E band in 2001-16F



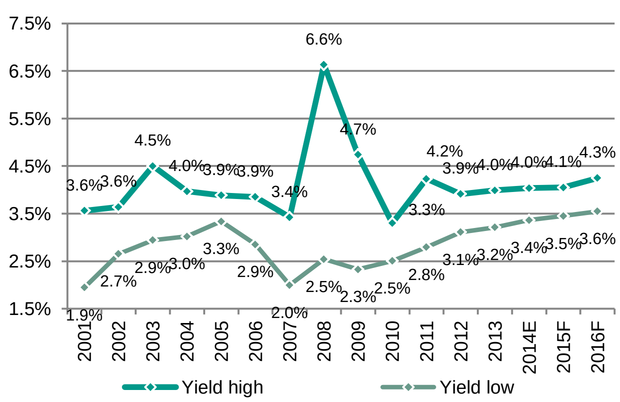
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 7: HSI's P/B band in 2001-16F



Source(s): Bloomberg, ABCI Securities estimates

Exhibit 8: HSI's dividend band in 2001-16F



Source(s): Bloomberg, ABCI Securities estimates

Review of 2014 – H-share Index

The ROAE of HSCEI Index ("H-share Index") has been trending down since 2011, and we expect the index's ROAE to fall to 15.5% for 2014F, down 0.5ppt from 2013. The decline in ROAE can be attributed to the fallen ROAE in China's financial sector. Hang Seng China H-Financials Index ("H-Fin Index"), which tracks the H-share banking, insurance, securities and assets management stocks, is expected to register an ROAE of 17.5% for 2014F, down 0.6ppt from 2013, as the index's profitability has declined for 3 consecutive years. Improvement in the A-share capital market and increased financial leverage in China insurance and brokerage industries have boosted earnings in 2014, but continuous deleveraging of China's banking sector and the increased NPL provision have dragged down earnings growth.

For non-financial H-share sectors, cyclical counters such as energy resources and base material stocks are expected to post negative EPS growth in 2014. Lower energy resources prices help elevate earnings of power producers. Separately, infrastructure contractors are boosted by the surge in subway construction across China.

Outlook for 2015 – H-share Sector

The following will be the major investment themes in 2015:

Shifting focus from GDP growth to GNP growth. The Chinese government is prioritizing growth in employment market and household income over the country's economic expansion. Moreover, the government is encouraging local enterprises or residents to invest in or develop overseas markets, signaling its intention to create national wealth outside the country. Although the government has not specified any GNP growth targets, we believe their attitude reveals the country's emerging focus on GNP.

Counter-cyclical measures. China will implement counter-cyclical measures in both the monetary and fiscal fronts to smooth out economic shocks. Thus, the country and market risk premiums should reduce accordingly. Overall, reduction of systematic risk will elevate valuations in the market. The government, however, is refrained from implementing full-fledged stimulus measures. Hence, non-systematic risk in industries, including surplus capacity, will remain high.

Interest rates liberalization. RMB internationalization and expansion of RMB exchange rate band. These developments will continue in coming years. Commercial banking industry will face a tough operating environment; capital services providers, such as securities and assets management industries, will benefit from such progresses.

SOE reforms – To enhance competitive strength and to improve corporate governance of SOE, the reforms will reduce non-systematic risk of SOE and enhance their profitability. While the transformation will present challenges, the market will be bullish on SOEs undergoing such reforms.

Clean energy and pollution control. We believe these areas will provide copious business opportunities in the public and private sectors.

"Going out" policy. We believe the Chinese government will play a more proactive role in encouraging companies in the infrastructure and financial sectors to invest in emerging or developing countries, especially those that the Chinese government is intending to establish a strong tie with.

Overall, we expect the EPS of H-share Index and H-Fin Index will grow 7.2% and 8.6% in 2015F, while the respective ROAEs will fall to 15.0% and 16.8% for the same period.

Assuming the counter-cyclical measures implemented in 2014 will filter into economy in 2015, the P/E band and P/B band of H-share Index will rise while the dividend yield band will fall. We forecast the trading range of H-share Index in 2015F to be 9,763 -13,266, representing 6.24x-8.48x 2015F P/E, 0.89-1.21x 2015F P/B or 5.16-3.80% 2015F dividend yield. We set the 2015F year-end target of H-share Index at 13,152, representing 8.41x 2015F P/E, 1.20x 2015F P/B, and 3.83% 2015F dividend yield.

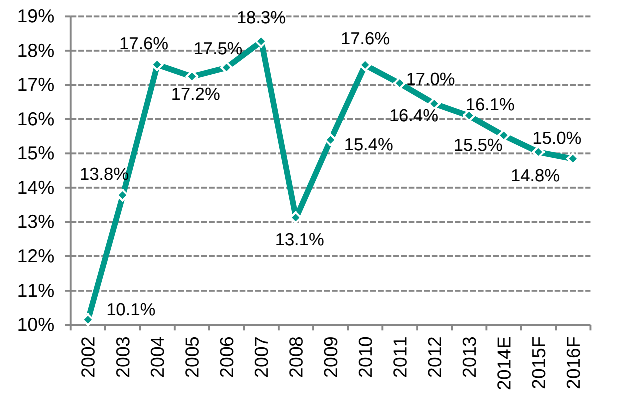
Exhibit 9: Projected trading range of H-share Index for 2015

Methods	Expected valuation band range in 2015			Corresponding H-Share Index trading range		
1	P/B high	P/B low	End-2015F	**Index high**	**Index low**	**End-2015F**
	1.35	1.00	1.33	13,288	9,843	13,092
2	P/E high	P/E low	End-2015F			
	9.00	6.50	8.90	13,133	9,485	12,987
3	Yield low	Yield high	End-2015F			
	3.50%	4.70%	3.50%	13,376	9,961	13,376

Average	**13,266**	**9,763**	**13,152**
Implied '15 P/E	8.48	6.24	8.41
Implied '15 P/B	1.21	0.89	1.20
Implied '15 yield	3.80%	5.16%	3.83%

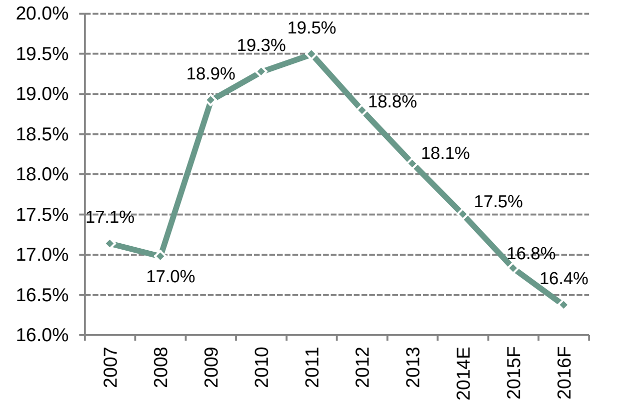
Source(s): ABCI Securities estimates

Exhibit 10: HSCEI's ROAE in 2002-16F



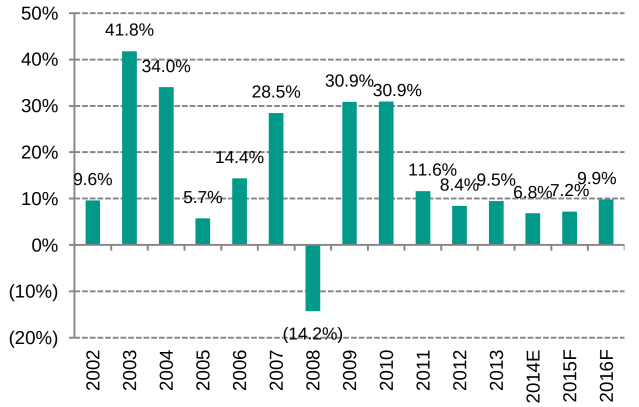
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 11: H-Fin Index's ROAE in 2007-16F



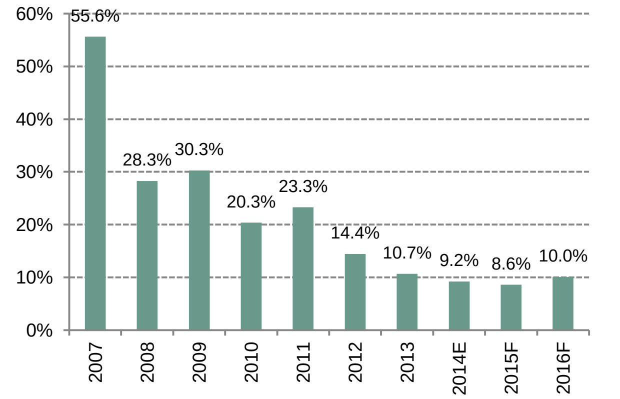
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 12: HSCEI's EPS growth from 2002-16F



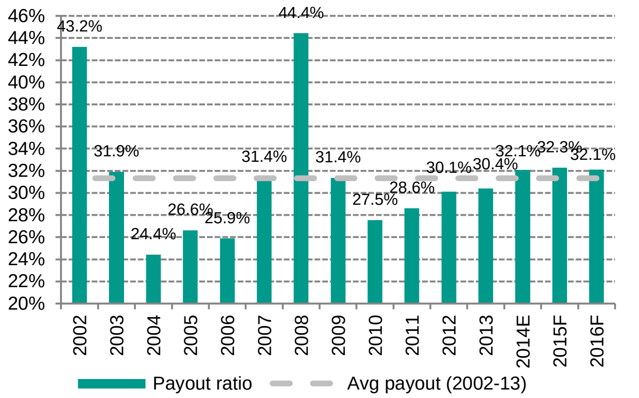
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 13: H-Fin Index's EPS growth in 2007-16F



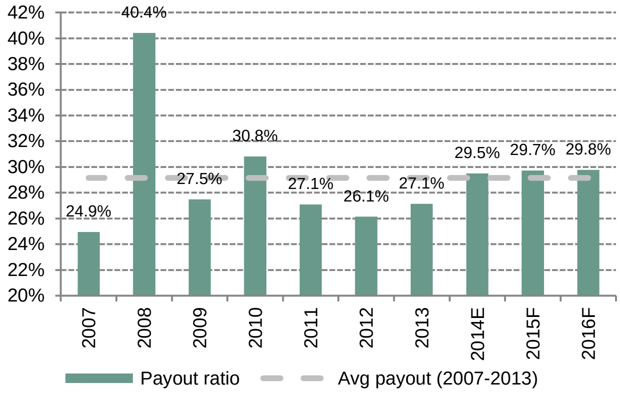
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 14: HSCEI's dividend payout ratio in 2002-16F



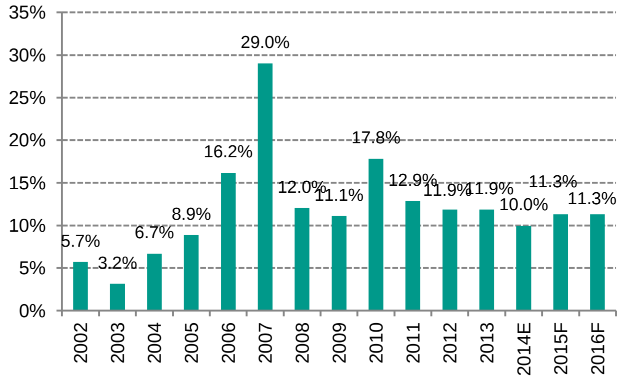
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 15: H- Fin Index dividend payout ratio in 2007-16F



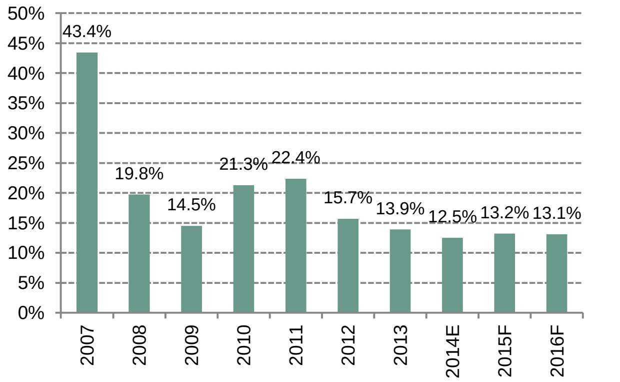
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 16: HSCEI's NBV growth in 2002-16F



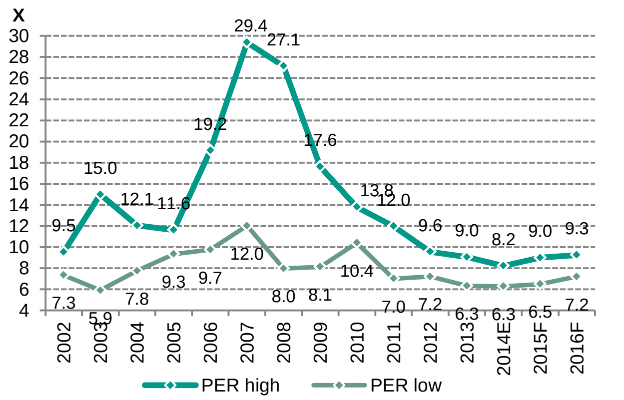
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 17: H-Fin Index's NBV growth in 2007-16F



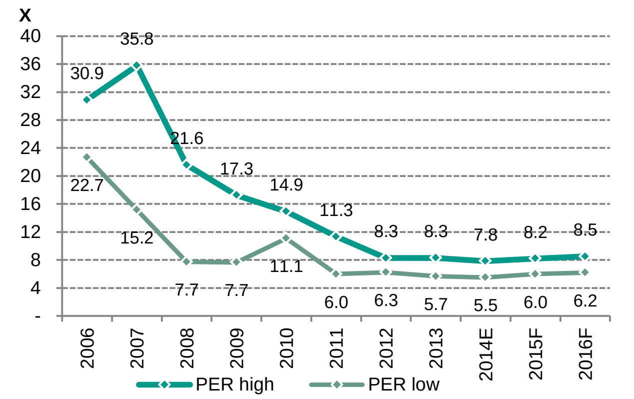
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 18: HSCEI's P/E band in 2002-16F



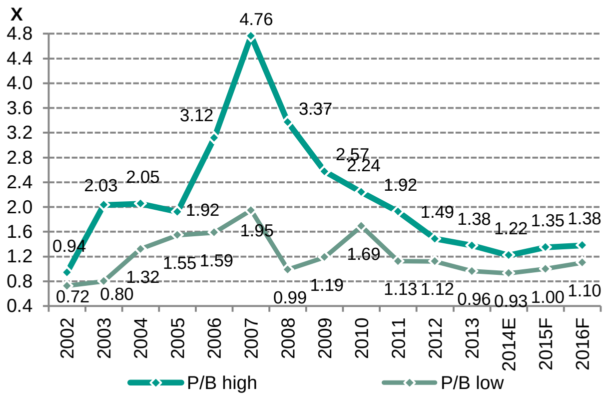
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 19: H-Fin Index's P/E band in 2006-16F



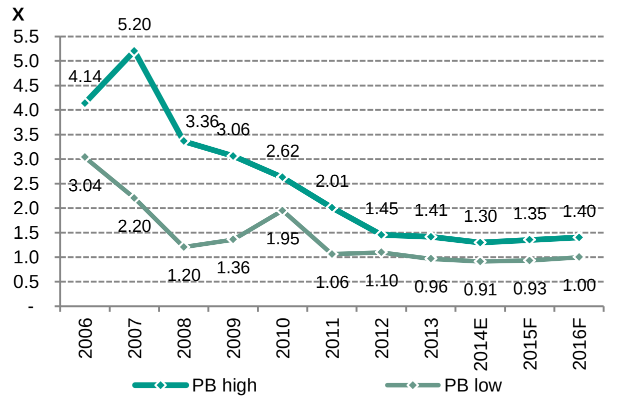
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 20: HSCEI's P/B band from in 2002-16F



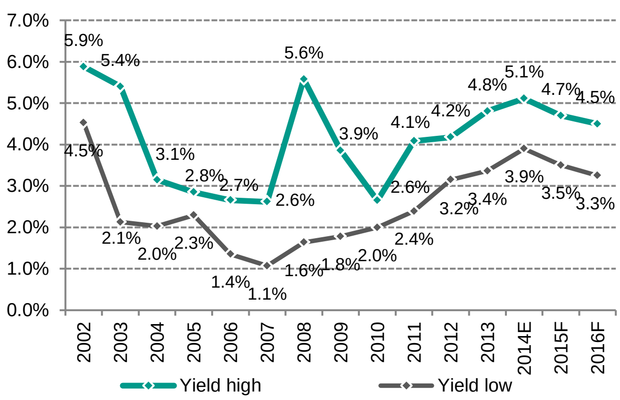
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 21: H-Fin Index's P/B band in 2006-16F



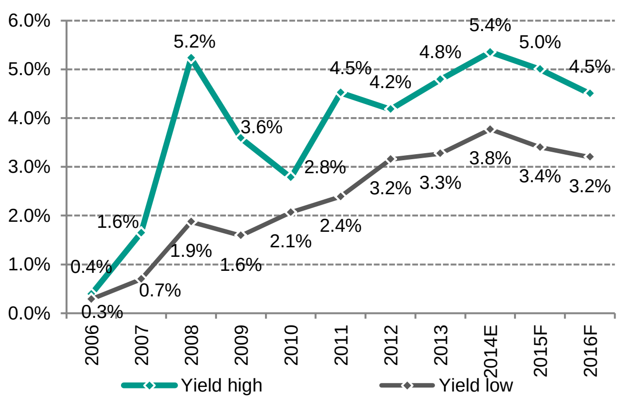
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 22: HSCEI's dividend yield band in 2002-16F



Source(s): Bloomberg, ABCI Securities estimates

Exhibit 23: H-Fin Index's dividend yield band in 2006-16F



Source(s): Bloomberg, ABCI Securities estimates

Exhibit 24: Hang Seng Index Stocks Market Valuation Table

Code	Stock name	Price (HK$)	2016F P/E (x)	2016F PEG (x)	2016F P/B (x)	2016F Yield (%)	2016F ROAE (%)	2015F P/E (x)	2015F PEG (x)	2015F P/B (x)	2015F Yield (%)	2015F ROAE (%)	2014E P/E (x)	2014E P/B (x)	2014E Yield (%)	2014E ROAE (%)
2	CLP HLDGS LTD	65.95	14.79	4.50	1.61	5.56	11.1	15.51	4.72	1.68	5.31	11.0	15.78	1.75	5.22	20.8
3	HONG KG CHINA GS	17.76	21.45	2.76	2.90	2.13	14.0	23.13	2.98	3.13	1.98	14.0	24.91	3.35	1.84	23.9
6	POWER ASSETS HOL	72.75	17.62	(132.54)	1.18	2.97	6.8	17.87	(134.42)	1.21	2.93	6.9	17.57	1.24	2.98	13.0
836	CHINA RES POWER	21.00	7.15	0.96	1.07	4.48	15.9	7.61	1.02	1.20	4.20	16.7	8.25	1.35	3.88	28.5
1	CHEUNG KONG	137.40	8.67	6.06	0.72	2.37	8.5	9.23	6.45	0.76	2.22	8.5	8.92	0.82	2.30	16.8
101	HANG LUNG PROPER	22.10	15.23	(44.43)	0.73	3.05	4.9	15.41	(44.96)	0.75	3.01	4.9	15.13	0.77	3.07	9.7
1109	CHINA RES LAND	20.00	7.47	0.44	0.98	2.38	13.8	8.76	0.51	1.09	2.03	13.2	10.23	1.22	1.74	20.7
12	HENDERSON LAND D	52.00	15.77	5.45	0.62	0.95	4.0	16.40	5.66	0.64	0.91	4.0	16.69	0.66	0.90	7.4
16	SHK PPT	112.50	12.52	1.72	0.67	1.84	5.4	13.51	1.86	0.69	1.70	5.2	14.41	0.71	1.60	5.0
17	NEW WORLD DEV	9.09	10.07	5.53	0.42	2.29	4.4	10.04	5.52	0.46	2.30	4.6	10.44	0.47	2.21	4.6
4	WHARF HLDG	55.00	11.06	0.87	0.55	1.16	5.0	12.35	0.98	0.56	1.04	4.6	14.03	0.58	0.91	7.5
688	CHINA OVERSEAS	23.95	6.46	0.45	1.11	2.64	18.6	7.31	0.51	1.30	2.33	19.2	8.46	1.52	2.02	30.5
823	LINK REIT	49.75	23.20	2.72	1.03	0.98	4.5	25.06	2.94	1.05	0.91	4.2	27.34	1.07	0.83	4.1
83	SINO LAND CO	12.46	12.73	2.30	0.61	2.20	4.9	13.69	2.47	0.64	2.05	4.7	14.18	0.65	1.98	4.7
388	HKEX	174.80	26.38	1.14	8.33	3.39	32.6	29.85	1.29	8.86	2.99	30.6	39.98	9.42	2.24	38.9
1299	AIA GROUP LTD	43.90	16.56	1.18	2.00	1.50	12.7	18.75	1.34	2.23	1.33	12.4	21.53	2.44	1.15	20.6
2318	PING AN INSURA-H	73.10	10.17	0.97	1.50	1.71	15.9	11.21	1.07	1.75	1.55	16.7	12.42	2.01	1.40	28.8
2628	CHINA LIFE INS-H	27.95	13.54	0.74	1.99	2.59	15.6	16.19	0.88	2.27	2.17	14.8	18.96	2.54	1.85	24.4
1398	ICBC-H	5.34	4.75	0.74	0.80	7.29	17.9	5.10	0.80	0.90	6.79	18.8	5.38	1.02	6.44	32.1
3328	BANK OF COMMUN-H	6.92	5.65	1.12	0.72	4.15	13.3	5.94	1.18	0.79	3.95	14.0	6.23	0.88	3.77	24.8
3988	BANK OF CHINA-H	4.16	4.72	0.56	0.71	7.38	15.8	5.18	0.61	0.79	6.72	16.1	5.55	0.89	6.27	27.8
939	CCB-H	5.99	4.50	0.65	0.76	7.74	17.9	4.84	0.70	0.86	7.19	18.8	5.14	0.97	6.77	32.2
11	HANG SENG BK	128.20	12.22	1.46	1.87	4.11	15.9	13.18	1.57	2.01	3.81	15.8	14.35	2.15	3.50	24.3
23	BANK EAST ASIA	31.10	10.13	2.03	0.93	4.11	9.5	10.88	2.18	1.00	3.83	9.4	11.17	1.05	3.73	17.1
2388	BOC HONG KONG HO	27.40	9.75	0.99	1.41	5.88	15.1	10.67	1.08	1.54	5.37	15.0	11.77	1.67	4.87	25.1
5	HSBC HLDGS PLC	77.15	9.64	1.25	0.94	5.66	9.9	10.47	1.35	0.97	5.21	9.5	11.20	1.01	4.87	16.6
762	CHINA UNICOM HON	11.52	12.14	0.68	0.87	3.62	7.3	14.60	0.81	0.91	3.01	6.4	16.90	0.95	2.60	10.8
941	CHINA MOBILE	94.30	12.77	3.30	1.50	3.39	12.2	13.71	3.54	1.61	3.16	12.2	13.78	1.74	3.14	22.1
700	TENCENT	118.20	22.06	0.76	6.19	0.51	32.0	27.86	0.96	8.24	0.40	33.9	36.69	11.03	0.31	50.2
992	LENOVO GROUP LTD	10.50	10.84	0.45	2.68	3.57	26.9	13.96	0.58	3.19	2.77	24.9	16.72	3.82	2.31	25.1

Code	Stock name	Price (HK$)	2016F P/E (x)	2016F PEG (x)	2016F P/B (x)	2016F Yield (%)	2016F ROAE (%)	2015F P/E (x)	2015F PEG (x)	2015F P/B (x)	2015F Yield (%)	2015F ROAE (%)	2014E P/E (x)	2014E P/B (x)	2014E Yield (%)	2014E ROAE (%)
144	CHINA MERCHANT	26.70	13.25	1.39	1.11	3.40	8.5	14.43	1.51	1.14	3.12	8.1	15.90	1.19	2.83	13.9
386	SINOPEC CORP-H	6.52	8.60	1.98	0.85	5.07	10.2	9.82	2.26	0.91	4.43	9.5	9.36	0.95	4.65	18.5
857	PETROCHINA CO-H	8.50	9.24	3.00	0.90	4.86	10.0	10.10	3.28	0.95	4.45	9.8	9.82	1.02	4.57	18.7
883	CNOOC LTD	10.98	7.46	(8.03)	0.87	4.02	12.2	8.12	(8.74)	0.95	3.70	12.2	7.32	1.03	4.10	24.5
135	KUNLUN ENERGY CO	8.04	8.12	0.66	0.98	3.39	12.6	9.69	0.78	1.07	2.84	11.6	10.26	1.18	2.68	20.4
1088	CHINA SHENHUA-H	23.80	8.60	1.90	1.06	4.56	12.9	9.27	2.05	1.17	4.23	13.1	9.40	1.27	4.17	23.5
293	CATHAY PAC AIR	17.68	10.18	0.25	0.95	3.49	9.6	12.78	0.31	1.01	2.78	8.2	20.32	1.07	1.75	10.2
66	MTR CORP	30.90	16.48	6.47	1.07	2.09	6.6	15.96	6.27	1.10	2.16	7.0	17.33	1.14	1.99	12.1
291	CHINA RES ENTERP	15.86	26.26	0.46	0.76	1.14	2.9	40.67	0.71	0.79	0.74	2.0	65.00	0.80	0.46	2.4
1928	SANDS CHINA LTD	40.70	12.33	0.94	5.56	8.09	47.1	14.63	1.12	6.08	6.82	42.9	15.77	6.49	6.32	61.4
27	GALAXY ENTERTAIN	47.15	12.62	0.75	3.27	-	28.6	15.39	0.92	4.04	-	29.2	17.22	5.04	-	46.6
151	WANT WANT CHINA	10.20	19.07	1.35	6.09	3.44	33.3	21.22	1.51	6.65	3.09	33.6	24.83	7.70	2.65	47.5
2319	CHINA MENGNIU DA	29.75	15.04	0.69	1.81	1.45	12.7	18.02	0.83	2.02	1.21	11.8	22.25	2.24	0.98	18.6
322	TINGYI	17.64	19.62	1.08	3.33	2.37	17.9	22.31	1.22	3.70	2.08	17.4	27.42	4.07	1.69	26.3
1044	HENGAN INTL	81.85	18.55	0.97	4.64	3.29	26.2	21.86	1.14	5.12	2.79	24.6	26.33	5.65	2.32	35.5
1880	BELLE INTERNATIO	8.68	11.18	1.64	1.80	2.24	16.7	12.09	1.78	1.94	2.07	16.6	12.76	2.08	1.96	28.1
494	LI & FUNG LTD	8.43	12.79	0.89	1.92	5.39	15.8	14.31	1.00	2.15	4.82	15.4	16.73	2.25	4.12	11.2
13	HUTCHISON WHAMPO	94.35	10.01	1.25	0.80	2.72	8.3	11.19	1.40	0.85	2.43	7.8	11.68	0.90	2.33	14.4
19	SWIRE PACIFIC-A	104.50	12.42	1.27	0.66	2.31	5.4	14.00	1.43	0.68	2.05	4.9	14.97	0.70	1.92	8.8
267	CITIC	13.92	7.14	0.41	0.56	2.72	8.2	8.36	0.48	0.61	2.32	7.5	9.87	0.65	1.97	12.0

Based on closing share prices on Dec 4, 2014
PEG = P/E / est. 2014-16 EPS CAGR
Source: Bloomberg, ABCI Securities calculations

Exhibit 25: H-share Index Stocks Market Valuation Table

Code	Stock name	Price (HK$)	2016F P/E (x)	2016F PEG (x)	2016F P/B (x)	2016F Yield (%)	2016F ROAE (%)	2015F P/E (x)	2015F PEG (x)	2015F P/B (x)	2015F Yield (%)	2015F ROAE (%)	2014E P/E (x)	2014E P/B (x)	2014E Yield (%)	2014E ROAE (%)
1398	ICBC-H	5.34	4.75	0.74	0.80	7.29	17.8	5.10	0.80	0.90	6.79	18.8	5.38	1.02	6.44	20.3
939	CCB-H	5.99	4.50	0.65	0.76	7.74	17.9	4.84	0.70	0.86	7.19	18.8	5.15	0.97	6.77	20.2
1288	AGRICULTURAL-H	3.69	4.44	0.56	0.76	7.81	18.2	4.81	0.61	0.86	7.21	19.1	5.17	0.98	6.71	20.3
3988	BANK OF CHINA-H	4.16	4.72	0.56	0.72	7.38	16.0	5.18	0.61	0.80	6.72	16.2	5.55	0.89	6.27	17.0
3328	BANK OF COMMUN-H	6.92	5.65	1.12	0.71	4.15	13.2	5.94	1.18	0.79	3.95	14.0	6.23	0.88	3.77	14.8
3968	CHINA MERCH BK-H	17.00	4.83	0.46	0.83	5.67	18.5	5.36	0.52	0.96	5.11	19.2	5.88	1.11	4.65	20.2
998	CHINA CITIC BK-H	5.83	4.58	0.62	0.67	5.89	15.5	4.91	0.66	0.75	5.49	16.2	5.28	0.85	5.11	17.1
1988	CHINA MINSHENG-H	9.17	4.50	0.63	0.77	5.06	18.4	4.88	0.69	0.89	4.67	19.7	5.15	1.04	4.42	22.0
2628	CHINA LIFE INS-H	27.95	13.54	0.74	2.06	2.59	16.1	16.19	0.88	2.30	2.17	15.0	18.96	2.56	1.85	14.2
2318	PING AN INSURA-H	73.10	10.17	0.97	1.60	1.71	16.8	11.21	1.07	1.84	1.55	17.7	12.42	2.14	1.40	18.6
1339	PICC GROUP-H	3.80	8.84	0.44	1.23	1.70	14.8	10.69	0.53	1.40	1.40	13.8	12.78	1.58	1.17	13.1
2601	CHINA PACIFIC-H	35.45	15.81	0.91	2.03	2.84	13.4	18.22	1.05	2.20	2.46	12.6	21.76	2.38	2.06	11.4
1336	NEW CHINA LIFE-H	36.30	10.21	0.85	1.46	0.58	15.3	11.59	0.96	1.69	0.51	15.7	12.82	1.96	0.46	16.5
2328	PICC P&C-H	15.86	10.83	0.78	2.12	3.57	21.0	12.94	0.93	2.45	2.99	20.2	14.06	2.79	2.75	20.9
6030	CITIC SECURITI-H	26.65	22.89	1.50	2.23	2.11	10.0	26.61	1.75	2.36	1.82	9.1	30.39	2.49	1.59	8.5
6837	HAITONG SECURI-H	17.06	17.20	1.15	1.72	2.20	10.3	19.62	1.31	1.84	1.93	9.7	22.76	1.96	1.66	8.9
1359	CHINA CINDA-H	4.19	6.48	0.28	1.02	2.31	16.9	7.86	0.34	1.18	1.91	16.1	9.84	1.36	1.52	14.7
1088	CHINA SHENHUA-H	23.80	8.60	1.90	1.07	4.56	12.9	9.27	2.05	1.16	4.23	13.0	9.40	1.26	4.17	13.9
1898	CHINA COAL ENE-H	5.31	22.07	0.38	0.61	1.33	2.8	31.69	0.54	0.63	0.93	2.0	55.45	0.64	0.53	1.1
857	PETROCHINA CO-H	8.50	9.24	3.00	0.92	4.86	10.2	10.10	3.28	0.98	4.45	9.9	9.82	1.03	4.57	10.8
386	SINOPEC CORP-H	6.52	8.60	1.98	0.88	5.07	10.6	9.82	2.26	0.94	4.43	9.9	9.36	1.00	4.65	11.0
2883	CHINA OILFIELD-H	13.86	6.47	7.49	0.92	4.09	15.0	6.71	7.76	1.03	3.94	16.2	6.59	1.16	4.02	18.8
902	HUANENG POWER-H	9.21	7.74	2.13	1.26	7.22	16.9	8.02	2.21	1.36	6.97	17.7	8.32	1.48	6.72	18.7
916	CHINA LONGYUAN-H	8.07	12.44	0.46	1.30	1.53	10.9	14.49	0.54	1.42	1.31	10.3	20.02	1.56	0.95	8.0
390	CHINA RAIL GR-H	5.55	7.42	0.76	0.81	2.03	11.4	8.05	0.82	0.89	1.87	11.6	8.93	0.98	1.69	11.5
1800	CHINA COM CONS-H	7.63	6.10	0.69	0.76	3.86	13.0	6.71	0.76	0.84	3.51	13.1	7.23	0.93	3.26	13.5
2338	WEICHAI POWER-H	30.75	8.71	1.02	1.19	1.49	14.5	10.08	1.18	1.35	1.29	14.2	10.26	1.53	1.26	15.9

Code	Stock name	Price (HK$)	P/E (x)	2016F PEG (x)	2016F P/B (x)	2016F Yield (%)	2016F ROAE (%)	2015F P/E (x)	2015F PEG (x)	2015F P/B (x)	2015F Yield (%)	2015F ROAE (%)	2014E P/E (x)	2014E P/B (x)	2014E Yield (%)	2014E ROAE (%)
1211	BYD CO LTD-H	41.80	32.88	0.50	2.99	0.61	9.5	43.60	0.66	3.24	0.46	7.7	90.15	3.48	0.22	3.9
489	DONGFENG MOTOR-H	11.36	5.13	0.56	0.78	2.84	16.4	5.72	0.62	0.90	2.55	16.9	6.12	1.05	2.38	18.5
2238	GUANGZHOU AUTO-H	7.09	6.45	0.25	0.84	6.10	13.7	7.80	0.31	0.93	5.04	12.4	10.16	1.01	3.87	10.3
2333	GREAT WALL MOT-H	38.20	7.58	0.34	1.81	3.76	26.2	8.82	0.40	2.21	3.23	27.7	11.32	2.74	2.52	26.4
2202	CHINA VANKE CO-H	16.90	6.22	0.37	1.17	3.24	20.4	7.19	0.43	1.38	2.80	20.9	8.46	1.64	2.38	21.0
914	ANHUI CONCH-H	27.45	8.39	1.00	1.32	2.25	16.8	9.13	1.09	1.52	2.07	17.9	9.86	1.76	1.92	19.3
3323	CHINA NATL BDG-H	7.59	5.06	0.84	0.64	2.93	13.3	5.22	0.87	0.71	2.85	14.5	5.68	0.81	2.61	15.1
358	JIANGXI COPPER-H	14.00	13.42	6.53	0.79	2.95	6.0	14.12	6.87	0.82	2.81	5.9	13.98	0.84	2.84	6.1
1066	SHANDONG WEIG-H	6.52	17.08	1.01	2.00	2.03	12.2	19.24	1.14	2.18	1.81	11.8	23.31	2.37	1.49	10.6
1099	SINOPHARM-H	27.70	13.79	0.68	1.91	2.14	14.6	16.69	0.82	2.13	1.77	13.4	19.99	2.36	1.48	12.3
168	TSINGTAO BREW-H	56.05	22.91	1.81	3.12	1.19	14.4	25.58	2.02	3.48	1.07	14.3	29.08	3.88	0.94	14.0
728	CHINA TELECOM-H	4.71	12.98	1.09	0.96	3.22	7.5	14.72	1.24	1.00	2.84	7.0	16.25	1.05	2.57	6.6
753	AIR CHINA LTD-H	5.87	10.45	0.34	0.92	1.67	9.2	12.01	0.39	1.00	1.45	8.6	17.85	1.08	0.98	6.2

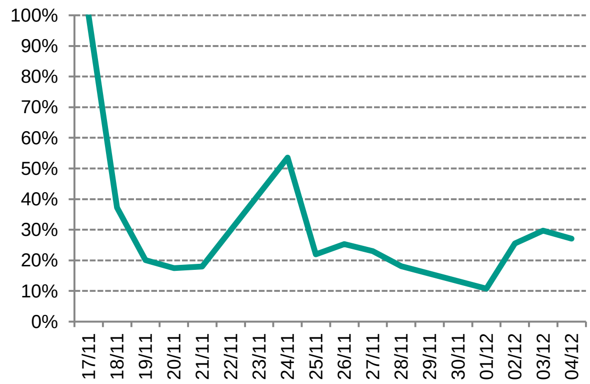
Based on closing share prices on Dec 4, 2014
PEG = P/E / est. 2014-16 EPS CAGR
Source: Bloomberg, ABCI Securities calculations

Shanghai-Hong Kong Stock Connect – Investment Strategy

Diminished enthusiasm for the Connect is a short-term norm

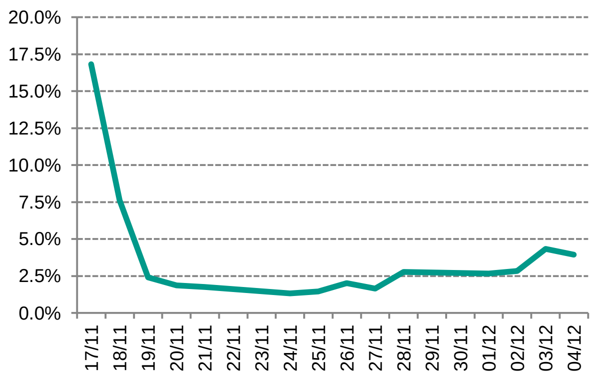
The launch of Shanghai-Hong Kong Stock Connect signals a milestone toward greater liberalization in China's capital markets. The trading link between the two major stock exchanges allows overseas investors to access China's A-shares through the Hong Kong Exchanges (HKEx), and mainland investors to access Hong Kong shares through the Shanghai Stock Exchange (SSE). Nonetheless, the trading amount is subject to quotas in both markets. High expectations on transaction volume and index performance have been building up since the scheme was announced on Apr 10, 2014. The trading platform was launched on Nov 17, 2014, but transaction volume was disappointing for the first 18 trading days trading days, as high hopes that billions of dollars would be generated in daily cross-border trading did not materialize. For northbound investment, global investors flocked to buy shares in Chinese companies on the first day, but trading continued to fall thereafter. Hong Kong investors used up an average of 31.5 % of their daily allowance of Shanghai shares. For southbound investment, the mainland investors used up only an average of 3.9% of their Hong Kong quota, reflecting that southbound investment lagged behind that of the northbound. Behaviors of China and Hong Kong investors indicate cautiousness, and we believe it will take time for the investing community to familiarize with cross-border trading in terms of stock choices and relevant trading regulations. We are of the view that the stock connect will improve trading and enhance financial integration between the two exchanges over time, furthering the cause of developing a more open and sophisticated financial landscape in China. In the medium and long term, the scheme will expand to the Shenzhen Stock Exchange and cover other asset classes.

Exhibit 26: SH-HK Connect (Northbound) percentage of Quota Used



Note: Daily quota for northbound trading is RMB 13 bn
Source(s): Bloomberg, ABCI Securities

Exhibit 27: SH-HK Connect (Southbound) – percentage of Quota Used

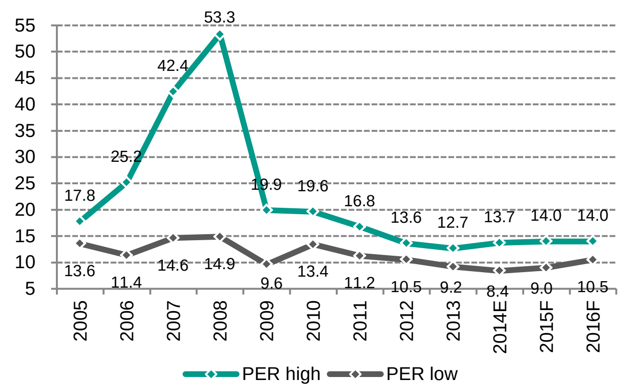


Note: Daily quota for southbound trading is RMB 10.5 bn
Source(s): Bloomberg, ABCI Securities

2015 Outlook for Shanghai Composite Index and CSI 300 Index

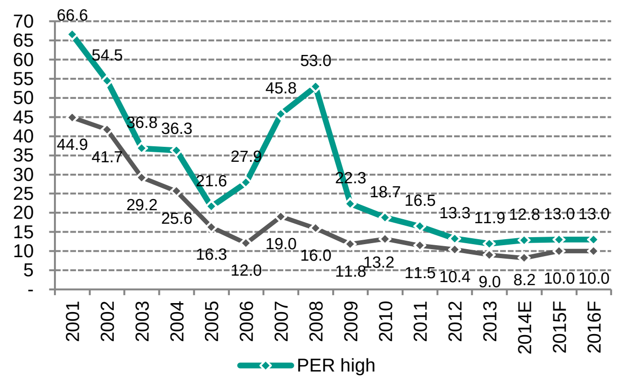
We believe the P/E range band of the A-share markets will trend higher on the declining market systematic risk; such risk will fall further in 2015-16 as interest rates decline in China. We forecast the P/E band of Shanghai Composite Index will rise to 10.0x-13.0x in 2015F from 8.2x-12.8x in 2014 and 9.0x-11.9x in 2013, representing a trading range of 2,697-3,506. Meanwhile, we forecast the P/E band of CSI 300 Index will rise to 9.0-14.0x in 2015F from 8.4-13.7x in 2014 and 9.2-12.7x in 2013, representing a trading range of 2,551-3,969. We expect more listing approvals for large-cap SOEs will be granted in 2015, and these new constituent stocks will become a swing factor to the Shanghai Composite Index and CSI 300 Index.

Exhibit 28: CSI 300 Index P/E Band (2005-16F)



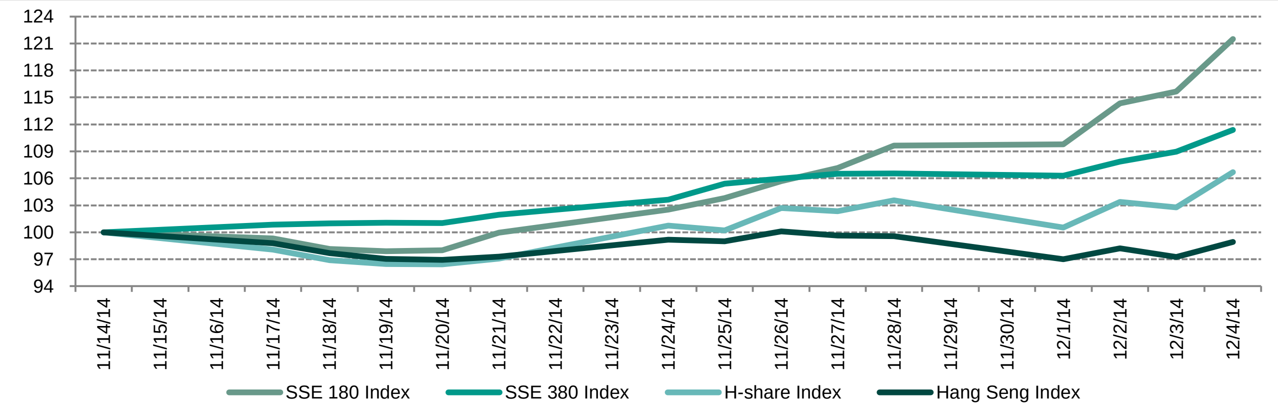
Source(s): Bloomberg, ABCI Securities estimates

Exhibit 29: Shanghai Composite Index P/E Band (2001-16F)



Source(s): Bloomberg, ABCI Securities estimates

Exhibit 30: SH-HK Connect – Relative Performance of indices



Note: 100= Closing on Nov 14, 2014 (a day before the SH-HK stock connect is launched)

Source(s): Bloomberg, ABCI Securities

Northbound Investment Strategy

Northbound investment under the connect scheme implies global investors can invest in selected A shares through the SH-HK stock exchange platform. As institutional investors have better knowledge on A-share market through QFII and RQFII programs, we believe most northbound investments are conducted by this specific group. Enthusiasm among the retail investors in HK will increase once they become more familiar with the operation and investment norm of the A-share market. Although the trading volume is still low at present, we are positive on the performance of A-share market as we believe Chinese shares will soon be included into the global benchmark index, which will present great investment opportunities for global investors under the scheme. In general, during the first 2 weeks of trading, we observe that the appetite of offshore investors for A shares mainly gears toward: (1) well-known Chinese consumer brands that were previously inaccessible to foreign investors; (2) stocks with a higher A-H discrepancy; (3) sectors' leaders; (4) and stocks with low valuations. We believe the trend will continue and the followings are some of our selected picks for northbound investors:

Exhibit 31: Well-known Chinese consumer brands

Stock name	Stock code	2014F P/E	2015F P/E	2014F P/B	2015F P/B
Tsingtao Brewery Co Ltd	600600	25.81	22.88	3.46	3.11
Yili	600887	18.89	15.35	3.93	3.62

Based on closing on Dec 4, 2014
Source(s): Bloomberg, ABCI Securities calculations

Exhibit 32: Stocks with A-H discrepancy

Stock name	Stock code	Discount to H- shares %	2014F P/E	2015F P/E	2014F P/B	2015F P/B
China Pacific Insurance Group	601601	4.2	20.98	17.35	2.17	1.97
Huaneng Power International	600011	2.9	8.24	8.08	1.44	1.32

Based on closing on Dec 4, 2014
Source(s): Bloomberg, ABCI Securities calculations

Exhibit 33: Sectors' leader

Stock name	Stock code	Sector	2014F P/E	2015F P/E	2014F P/B	2015F P/B
ICBC	601318	Banks	5.37	5.07	1.03	0.91
CCB	601939	Banks	5.61	5.32	1.07	0.94
China Life	601628	Insurance	22.20	18.87	2.73	2.43
China Railway Group	601390	Infrastructure	10.30	9.27	1.14	1.04
Citic Securities	600030	Securities	29.89	25.42	2.46	2.29
China Merchants securities	600999	Securities	39.60	32.93	3.32	3.08
Poly Real Estate	600048	Property	6.41	5.34	1.33	1.10
China Fortune Land	600340	Property	12.85	9.28	4.85	3.34
Shanghai Fosun	600196	Pharmaceutical	21.32	17.87	2.78	2.47
Kweichow Moutai	600519	Wine	12.60	11.54	3.70	3.14
SAIC Motor Corporation	600104	Auto	8.39	7.38	1.52	1.35
Baotou Beifang Chuangye	600967	Machinery & Military	33.98	22.92	4.11	3.50
Huaneng Power	600011	Thermal power	8.24	8.08	1.44	1.32
Yangtze Power	600900	Hydropower	14.75	14.34	1.82	1.72
Shanghai Int'l Airport	600009	Airport	16.50	14.85	1.90	1.74
Shanghai Int'l Port	600018	Container ports	22.19	20.27	2.56	2.34
Anhui Conch Cement	600585	Cement	8.68	7.99	1.59	1.39

Based on closing on Dec 4, 2014
Source(s): Bloomberg, ABCI Securities calculations

High adaptability amid changes

- China banks sector has demonstrated high adaptability through swift responses to regulatory and environmental changes
- Amid NIM pressure increases on interest rate cut, strong loan demand will support loan pricing and stabilize NIM
- New NPLs are emerging form non-coastal areas, yet it is too early to confirm an NPL contagion scenario. Banks would need to increase NPL handling in 2015
- Maintain **OVERWEIGHT** for China banks sector

China Banks Sector

Overweight

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High adaptability amid challenges. The China banks sector has been depressed by a multitude of economic and regulatory factors. Nonetheless, banks have demonstrated high adaptability to changes, as reflected by the latest financial results. We believe the market, to a certain extent, has become desensitized to negative news and we forecast valuation of the sector will normalize in 2015. Maintain **OVERWEIGHT.**

Prompt reactions to changes. Banks have been able to react promptly and prepare early for policy and operational changes. Recent examples include early adjustment in CAR positions under the new capital rule and their swift responses during the interbank liquidity crisis in June 2013. We expect more policies regulating internet finance and innovative products will be launched in 2015.

Loan pricing to offset rise in deposit cost. We expect a mild NIM pressure to persist in 2H14 and 2015 with the resumption of interest rate cut cycle, although the impact would be alleviated partially by the solid loan demand, which would in turn support loan pricing. Meanwhile, deposit competition is not as keen as the market perceives. The surge in deposit cost has been mainly driven by the gradual deposit migration instead of price competition in our view.

Asset quality trend warrants concern. NPL trend has been rising gently among the Chinese banks. It is worth noting that new NPLs are emerging from non-coastal regions, as well as the transportation and mining sectors. However, we believe it is too early to confirm an NPL contagion although the current trend does warrant concerns. We believe that changes in asset quality would not have significant impacts on banks' earnings given the rapid expansion of distressed asset sector.

ICBC (1398 HK, BUY). We continue to favor big banks. ICBC's defensive operation and leading market position should render it more resilient toward policy changes. We deem its current valuation at 0.86x FY15E P/B as attractive.

CCB (939 HK, BUY). CCB's prudent management has always been its strongest suit. The bank recorded a NIM expansion of 1bp QoQ in 3Q14 and asset quality has been stable. Its current valuation is at 0.82x FY15E P/B.

Risk factors: 1) Interest rate liberalization proceeds faster than expected; 2) Increasing competition from non-bank financial institutions; 3) Sharp asset

Key Data

Avg.14F P/E (x)	5.17
Avg.14F P/B (x)	0.89
Avg.14F Dividend Yield (%)	5.45

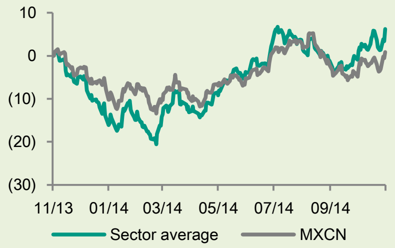
Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

	Absolute	Relative*
1-mth	6.60	1.48
3-mth	2.40	4.70
6-mth	16.09	7.57

* Relative to HSCEI
Source(s): Bloomberg, ABCI Securities

1-Year Sector performance (%)



Source(s): Bloomberg, ABCI Securities

quality deterioration and weak loan demand; 4) New regulations affecting banks' operation and profitability.

Exhibit 1: NIM trend of the Chinese banks

	1Q13	2Q13	QoQ	3Q13	QoQ	4Q13	QoQ	1Q14	QoQ	2Q14	QoQ	3Q14	QoQ
ICBC	2.59	2.56	(0.03)	2.56	-	2.59	0.03	2.60	0.01	2.64	0.04	na	na
CCB	2.71	2.71	-	2.71	-	2.82	0.11	2.81	(0.01)	2.79	(0.02)	2.80	0.01
ABC	2.78	2.70	(0.08)	2.77	0.07	2.92	0.15	2.96	0.04	2.90	(0.06)	2.87	(0.03)
BOC	2.22	2.24	0.02	2.20	(0.04)	2.31	0.11	2.29	(0.02)	2.25	(0.04)	2.24	(0.01)
BoCom	2.53	2.47	(0.06)	2.40	(0.07)	2.38	(0.02)	2.32	(0.06)	2.46	0.14	2.42	(0.02)
MSB	2.45	2.39	(0.06)	2.30	(0.09)	2.84	0.54	2.62	(0.22)	2.62	-	2.59	(0.03)
CMB	2.93	2.85	(0.08)	2.73	(0.12)	2.79	0.06	2.65	(0.14)	2.49	(0.16)	2.39	(0.10)
CITICB	2.65	2.55	(0.10)	2.60	0.05	2.61	0.01	2.37	(0.24)	2.35	(0.02)	2.39	0.04
CEB	2.67	2.23	(0.44)	2.59	0.36	2.16	(0.43)	2.51	0.35	2.25	(0.26)	na	na
CQRB	3.31	3.49	0.18	3.40	(0.09)	3.48	0.08	3.39	(0.09)	3.37	(0.02)	3.32	(0.05)
Big 5 banks avg	**2.57**	**2.54**	**(0.03)**	**2.53**	**(0.01)**	**2.60**	**0.08**	**2.60**	**(0.01)**	**2.61**	**0.01**	**2.58**	**(0.02)**
Mid-cap banks avg	**2.68**	**2.60**	**(0.08)**	**2.54**	**(0.05)**	**2.75**	**0.20**	**2.55**	**(0.20)**	**2.49**	**(0.06)**	**2.46**	**(0.03)**
All	**2.68**	**2.62**	**(0.06)**	**2.63**	**0.01**	**2.69**	**0.06**	**2.65**	**(0.04)**	**2.61**	**(0.04)**	**2.63**	**0.02**

Source(s): Wind, company reports, ABCI Securities

Exhibit 2: NPL ratio trend of the Chinese banks

	1Q13	2Q13	QoQ (%)	3Q13	QoQ (%)	4Q13	QoQ (%)	1Q14	QoQ (%)	2Q14	QoQ (%)	3Q14	QoQ (%)
ICBC	0.87	0.87	-	0.91	0.04	0.94	0.03	0.97	0.03	0.99	0.02	1.06	0.07
CCB	0.99	0.99	-	0.98	(0.01)	0.99	0.01	1.02	0.03	1.04	0.02	1.13	0.09
ABC	1.27	1.25	(0.02)	1.24	(0.01)	1.22	(0.02)	1.22	-	1.24	0.02	1.29	0.05
BOC	0.91	0.93	0.02	0.96	0.03	0.96	-	0.98	0.02	1.02	0.04	1.07	0.05
BoCom	0.97	0.99	0.02	1.01	0.02	1.05	0.04	1.09	0.04	1.13	0.04	1.17	0.04
MSB	0.76	0.78	0.02	0.78	-	0.85	0.07	0.87	0.02	0.93	0.06	1.04	0.11
CMB	0.66	0.71	0.05	0.79	0.08	0.83	0.04	0.85	0.02	0.98	0.13	1.1	0.12
CITICB	0.88	0.90	0.02	0.90	-	1.03	0.13	1.15	0.12	1.19	0.04	1.39	0.20
CEB	0.79	0.80	0.01	0.82	0.02	0.86	0.04	0.97	0.11	1.11	0.14	1.07	(0.04)

Source(s): Wind, company reports, ABCI Securities

Exhibit 3: Sector Valuation Summary (Data as of Nov 28, 2014)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY14F P/E(x)	FY15F P/E (x)	FY14F P/B (x)	FY15F P/B (x)	FY14F Yield (%)	FY15F Yield (%)
ICBC	1398 HK	BUY	6.24	18.63	5.20	4.78	1.02	0.90	6.65	7.13
CCB	939 HK	BUY	6.90	17.35	5.11	4.75	0.97	0.86	6.80	7.44
ABC	1288 HK	BUY	4.54	23.37	4.91	4.39	0.99	0.86	7.13	7.81
BOC	3988 HK	BUY	4.45	11.25	5.33	4.85	0.86	0.77	6.56	7.19
BoCom	3328 HK	BUY	6.94	7.93	5.98	5.36	0.82	0.74	5.05	5.64
CMB	3968 HK	BUY	17.30	7.72	5.66	4.85	1.04	0.90	5.29	6.23
MSB	1988 HK	BUY	9.55	12.09	4.03	3.64	0.97	0.83	3.96	4.25
CITICB	998 HK	HOLD	5.37	-6.93	5.43	4.71	0.84	0.73	5.42	6.28
CEB	6818 HK	BUY	4.48	13.13	4.87	4.34	0.85	0.76	5.68	6.31
HB	3698 HK	BUY	4.03	19.58	5.74	5.09	0.80	0.69	4.45	5.19
HRB	6138 HK	BUY	3.53	30.74	5.40	4.91	0.80	0.69	3.70	4.63
BoCQ	1963 HK	BUY	6.38	12.92	4.35	4.00	0.74	0.63	4.65	5.53

Source(s): Bloomberg, ABCI Securities estimates

Capital market reform to spur growth

- SH-HK stock connect would fuel market sentiment and enhance investors' confidence, benefiting multiple business lines
- Robust momentum in MFSL business will continue with revenue contribution increasing to 20%-25% in 2015F from 18% in 1H14
- Fee income from investment banking rebounded sharply in FY14 on IPO resumption in China; the momentum is expected to extend into 2015
- We are positive on China brokers as they will be the key beneficiaries of the capital market reforms; our top pick is CGS (6881 HK)

Brokerage Sector

Overweight

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Strong trading volume in the A-share market. SHCOMP index rose 15% in 3Q14 and has exceeded the 2,600 level in Nov to hit the year's high. We expect the index to edge up 10%-15% in 2015 amid improving liquidity and optimistic market sentiment spurred by the SH-HK stock connect. Upon announcement on the interest rate cut, A-share market turnover hit record high on Nov 28 with ADT reaching over RMB 700bn. 11M14 ADT was RMB 251bn (vs. 10M14: RMB 232bn). For 2015F, we expect ADT of the A-share market to reach RMB 340-350bn; market capitalization of tradable A-shares will amount to RMB 32-33tr (as at end-Nov: RMB 27.2tr), while annual turnover velocity of tradable A-shares will maintain at ~250%-260%.

Robust momentum in MFSL business is likely to persist. The scale of margin financing and securities lending (MFSL) business has grown rapidly since its inception. Balance of MFSL in China surged from RMB 38bn in 2011 to RMB 825bn by end-Nov 2014. However, the penetration of margin financing is still low– only ~2% of A-share investors have opened a margin finance account. After surging 287% and 152% YoY in 2013 and 11M14, we expect the growth of MFSL system balance would normalize to 30%-40% YoY in 2015F, representing around 3.5% of tradable A-share market capitalization. Revenue contribution is likely to increase to 20%-25% in 2015F from 18% in 1H14.

Stellar growth in investment banking business. Since China restarted its A-share IPO market in 1Q14, a total of 81 companies have executed their IPOs by end-Sep. Secondary offerings have also remained strong. Total new equity funds raised in 9M14 (including IPO, placement and rights issuance) was RMB 528bn, up 78.4% YoY. Fee income from investment banking rebounded sharply in FY14, and we expect such momentum to extend into 2015.

Positive on the China's brokerage sector. China's brokers, the key beneficiaries of the capital market reforms, have sound prospects in our view. Our top pick is CGS (6881 HK) given its solid capital position, largest market share in brokerage income, and the highest ROAE among peers.

Risk factors: 1) Further decline in brokerage commission rates; 2) Sharp decline in A-market turnover; 3) Slowdown in China's economic growth; 4) Higher-than- expected proprietary trading loss; 5)Slowdown in A-share trading velocity.

Key Data

Avg.15F P/E (x)	20.42
Avg.15F P/B (x)	1.86
Avg.15F Dividend Yield (%)	1.51

Source(s): Bloomberg, ABCI Securities estimates

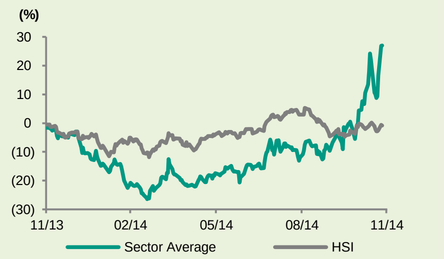
Sector performance (%)

	Absolute	Relative*
1-mth	36.35	34.37
3-mth	45.37	50.06
6-mth	51.77	55.85

* Relative to HSI

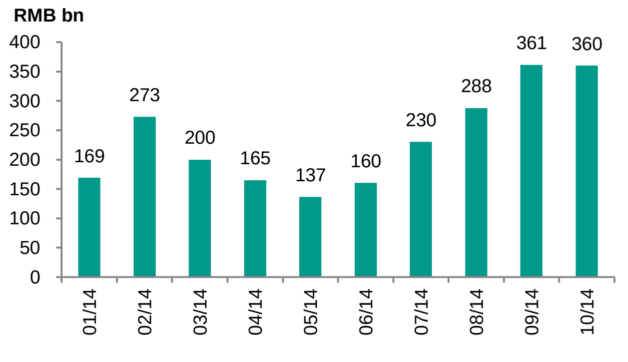
Source(s): Bloomberg, ABCI Securities

1-Year Sector performance (%)



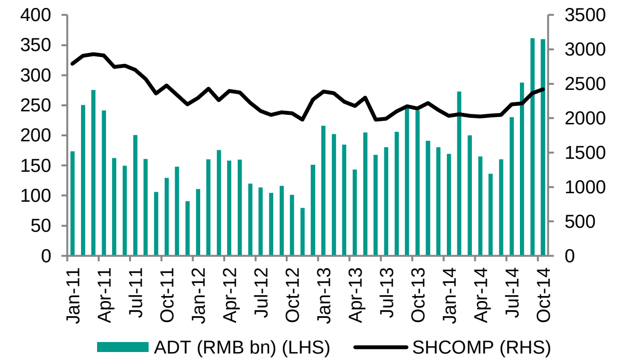
Source(s): Bloomberg, ABCI Securities

Exhibit 1: Monthly ADT of A-share market rebounded sharply in 3Q14



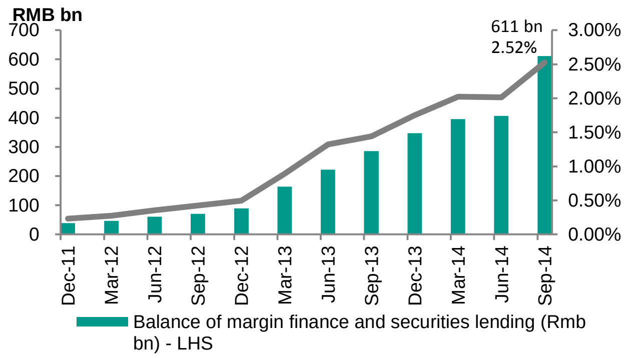
Source(s): Wind, ABCI Securities

Exhibit 2: SHCOMP index rose 15% in 3Q14



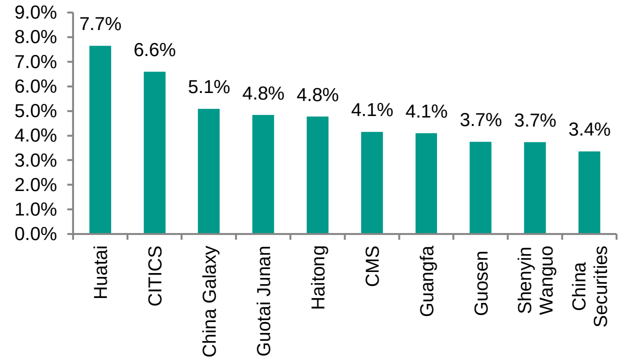
Source(s): Wind, Bloomberg, ABCI Securities

Exhibit 3: MFSL Balance in China



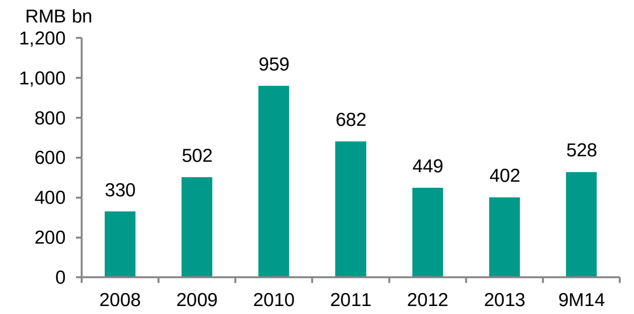
Source(s): Wind, ABCI Securities

Exhibit 4: Market share in terms of trading volume (stock + fund) in 9M14



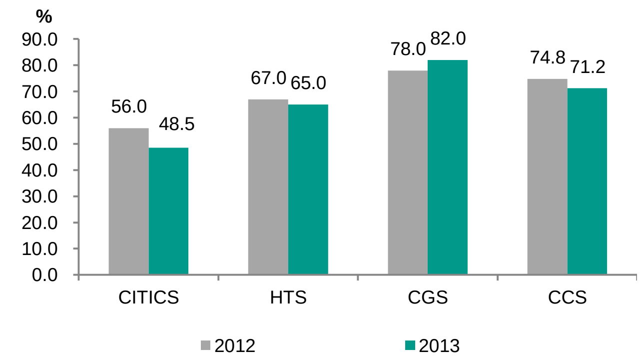
Source(s): Wind, ABCI Securities

Exhibit 5: Total new equity funds raised (including IPO, placement and rights issues)



Source(s): Wind, ABCI Securities

Exhibit 6: Net capital/net assets ratio for HK-listed Chinese brokers



Source(s): Company, ABCI Securities

Sector Valuation Summary (Data as of Nov 28, 2014)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY14F P/E(x)	FY15F P/E (x)	FY14F P/B (x)	FY15F P/B (x)	FY14F Yield (%)	FY15F Yield (%)
CITICS-H	6030 HK	N/A	N/A	N/A	26.1	22.9	2.1	2.0	1.3	1.4
HTS-H	6837 HK	N/A	N/A	N/A	22.3	19.2	1.9	1.8	1.3	1.6
CGS	6881 HK	BUY	12.00	51.0	17.1	15.2	1.7	1.6	1.6	1.7
CCS	1375 HK	N/A	N/A	N/A	20.7	16.3	1.7	1.6	0.8	1.1

Source(s): Bloomberg, ABCI Securities estimates

Clean energy to displace fossil fuels

- Changes in economic structure may lead to slower growth in power demand than that of the underlying economy in short-to-medium-term
- Dispatch priority policy favors clean energy producers over fossil-fuel ones
- Over the medium-to-long term, there will be emerging upside risks on hydro and nuclear tariffs ; downside risks of solar and wind tariffs will be increasing

Clean Energy Sector

Overweight

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Looming over-capacity risk in China's power industry. Owing to changes in the economic structure, power elasticity ratio has been below 1.0x since 2012. Installed capacity has been growing faster than power consumption. Falling average annual utilization rate of power generators hints at increasing over-capacity risk. Moreover, the State Council guided wind and solar tariffs will be slashed in the next 6 years. Nonetheless, overall power sector will benefit from downtrend of domestic interest rate cycle in 2015. The sector, with a beta below 1, will also lure risk-adverse investors.

Dispatch priority favors clean energy. Clean energy such as wind, solar, hydro, and nuclear will connect to grid prior to the fossil fuel. This policy protects and allows clean energy power sector to expand at the expense of market shares of fossil fuel power.

Nuclear power – good visibility on output growth. We predict State Council to grant ~9GW of new projects in 2015 to fulfill its target for 2020. Beneficiaries include CGNP, CNNP, China Nuclear Engineering Corp.

Wind power – strong capacity growth. Local governments have strong incentive to increase FAI in wind power. The capacity will grow at 14.9% CAGR in 2013-20F. However, ROAA and ROAE of this sector are low while downside tariff risk is imminent. Net profit should be driven by capacity growth. Cash calls in 2015 will likely be used to finance capex and reduce gearing.

Hydropower – high seasonality. Hydro demonstrated a boom-and-bust performance in alternate years due to seasonal factors. Good rainfall in 2014 translates into high utilization rate and net profit growth. However, outlook in 2015 remains cautious. Counters such as China Power (2380 HK), Huadian Fuxin (816) will be affected.

Solar power – lots of opportunities. Solar power capacity will grow at 26% CAGR in 2013-20F. Energy barriers in this segment are relatively low. Some solar equip players (Shunfeng,1165 HK; GCL Energy, 451 HK) are transforming to solar power producers, but their earning track records are still short at present.

Supply chain implications. Relatively strong capacity growth in solar, wind and nuclear in coming years is positive to upstream equipment suppliers. However, mild capacity growth in hydro is negative to its upstream players.

Risk factors: 1) Power elasticity ratio below 1.0x; 2) Falling assets utilization risk; 3) Tariff upside/downside risks; 4) Changes in policies and regulations may alter the competition landscape among various types of power producers; 5) Strong future capacity growth leading to frequent cash calls in coming years.

Key Data

Sector (note 1)	FY15	FY16
Avg. P/E (x)	12.11	9.64
Avg. P/B (x)	1.40	1.17
Avg. Dividend Yield (%)	1.67	1.94

Source(s): Bloomberg, ABCI Securities estimates

Note 1: Comparable H-share stocks include 916, 958, 1798, 956, 579, 2380, 816, 735, 1165

Sector performance

3 years avg. ROAA	2.23%
3 years avg. ROAE	9.16%
2014-16 EPS CAGR	37.8%
Net debt/equity	192%
Avg. beta (vs HSI)	0.64

Source(s): Bloomberg, ABCI Securities estimates

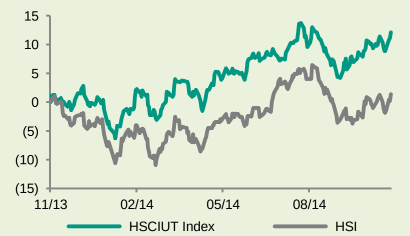
HS Composite Utility Index performance (%)

	Absolute	Relative*
3-mth	0.51	3.55
6-mth	6.59	2.66
12-mth	11.38	10.55

* Relative to Hang Seng Index

Source(s): Bloomberg, ABCI Securities

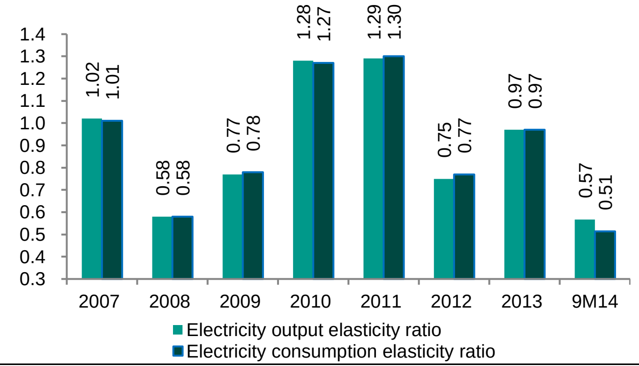
1-Year index performance (%)



Source(s): Bloomberg, ABCI Securities

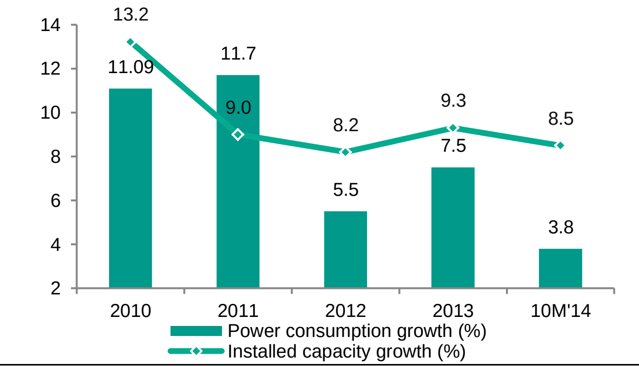
6) Actual capacity growth deviating from government's long-term capacity target.

Exhibit 1: Power output (consumption) growth/ Real GDP growth



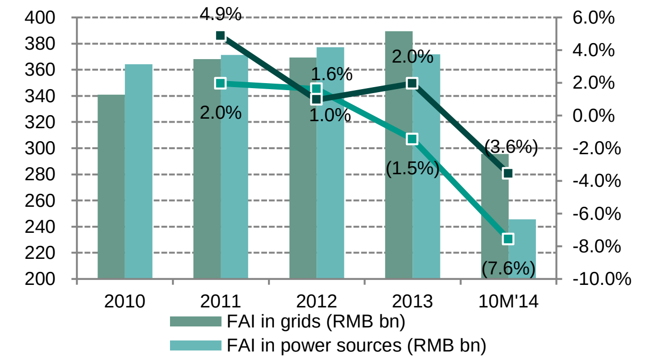
Source(s): NBSC, ABCI Securities

Exhibit 2: Over-capacity risk: installed capacity growth of power industry outpaced power consumption growth



Source(s): China Electricity Council, ABCI Securities

Exhibit 3: Completed investment in power grid & power sources (RMB bn) shows faltering momentum



Source(s): Wind, ABCI Securities

Exhibit 4: Power Dispatch Priority List : Who connects to grid first (in descending order)

1. Non-adjustable power units (e.g. wind & solar) utilizing renewable energy sources
2. Adjustable power units utilizing renewable energy sources and garbage power generation units meeting requirements of environmental protection (e.g. hydropower, geothermal , biomass, garbage incineration power)
3. Nuclear power
4. Coal cogeneration
5. Gas-fired & coal gasified power
6. Other coal-fired power
7. Oil-fired power

Source(s): State Council

Exhibit 5: Target installed capacity of clean energy

Year end	2013A	2015F^	2020F*	2013-15F	**2013-20F**
Installed Capacity	MnKW	MnKW	MnKW	CAGR	**CAGR**
Solar Power	19.42	21	100	4.0%	**26.4%**
Nuclear Power	14.61	40	58	65.5%	**21.8%**
Wind Power	75.48	100	200	15.1%	**14.9%**
Hydropower	280.02	290	350	1.8%	**3.2%**

* 12th 5-year plan set by NEA; ^: Goal set by State Council in Nov 2014;
Source(s): State Council, NEA, ABCI Securities estimates

Exhibit 6: Avg. annual utilization rate* shows a declining trend

	Overall	Nuclear	Thermal	Hydro	Wind
2011	**54.0%**	88.6%	60.6%	34.5%	21.6%
2012	**52.1%**	89.4%	56.7%	40.9%	22.0%
2013	**51.5%**	90.1%	57.2%	37.9%	23.7%
10M13	**51.3%**	89.4%	56.2%	39.4%	23.2%
10M14	**48.6%**	84.6%	53.0%	42.5%	20.6%

*Rate = avg. annual utilization hrs of power generators / total number of hrs during the period.
Source(s): NEA, ABCI Securities

Exhibit 7: Financial summary of China's power producers

Code	**Unit: %** **Stock**	**3-yr avg. ROAA**	**3-yr avg. ROAE**	**Net debt-to-equity**	**2014-16F EPS CAGR**
	Wind power				
916	Longyuan	2.49	8.88	146	26.9
958	Huaneng Renew	1.68	8.02	197	34.4
1798	Datang Renew	0.72	4.08	324	137.4
579	Jingneng Clean	3.27	10.05	191	32.4
	Hydropower				
600900	Yangtze Power	5.81	12.59	73	1.1

Code	**Stock**	**Unit: %** **3-yr avg. ROAA**	**3-yr avg. ROAE**	**Net Debt-to-equity**	**2014-16F EPS CAGR**
816	Huadian Fuxin	1.79	11.07	306	27.9
	Solar power				
735	China Power New	1.50	3.48	82	33.9
1165	Shunfeng	(11.91)	(60.06)	211	100.0
	Nuclear power				
	CGNP	4.14	22.94	221	N/A
	CNNP	2.88	12.97	339	N/A

Source(s): Bloomberg, ABCI Securities calculations

Favor the leader amid uncertainties

- Although coal prices have rebounded mildly since mid-Oct, weak downstream demand, energy reform, and competition from overseas continue to cloud prospects
- Sector consolidation will continue to deepen, favoring big players while eliminating smaller, inefficient ones
- We favor China Shenhua (1088 HK) for its leading position, strong transportation capacity, and attractive valuation at 1.05x FY15F P/B

China Coal Sector

Neutral

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Key Data

Avg.15F P/E (x)	12.52
Avg.15F P/B (x)	0.82
Avg.15F Dividend Yield (%)	2.83

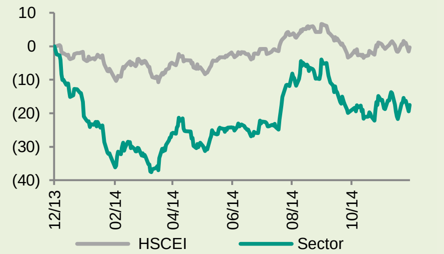
Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

	Absolute	Relative*
1-mth	3.49	(4.60)
3-mth	(5.95)	(6.22)
6-mth	7.03	(3.51)

* Relative to HSCEI
Source(s): Bloomberg, ABCI Securities

1-Year Sector performance (%)



Source(s): Bloomberg, ABCI Securities

Coal prices rebounded but downstream demand remains weak. China's Bohai-Rim Thermal Coal Prices rebounded by RMB 24/ton on Nov 5, 2014, up 4.9% MoM. The rebound could be a result of the short-term bargaining strategy deployed by giant coal producers. The mine-mouth price had been flat for 3 weeks by Oct 31 (near the peak season) but was ~RMB 10/ton lower than that on Aug 15 at the off season. Looking forward, China's weak economy and clean energy reform will continue to overshadow the coal sector.

2015 outlook is clouded. In 2015, coal miners would continue to be pressured by domestic oversupply and fierce competition from overseas suppliers. Though China has relaxed home-purchase controls and the central bank has reduced the interest rate to avoid a broad economic slowdown, the central government also emphasizes a preference for reform that follows a more sustainable growth model. The prudent monetary stance adopted implies that broad stimulus is highly unlikely to be implemented.

Imports may further stifle coal prices. China imposed a tariff of 3%~6% on low-quality coals starting from Oct 15, 2014. But the policy may have limited effect as most imports are from zero-tariff regions such as ASEAN. Coal imports will likely cap coal prices and pose threats to less efficient players in 2015. In the long run, sector restructuring will eliminate market players with low profitability.

China Shenhua (1088 HK, BUY). We like its leading position in the coal industry and high transportation capacity - an important fundamental to support business growth. Its valuation is attractive at 1.05 FY15F P/B based on its high ROE (~14% for FY14E-16E) and strong bargaining power. TP is set at HK$ 24.9.

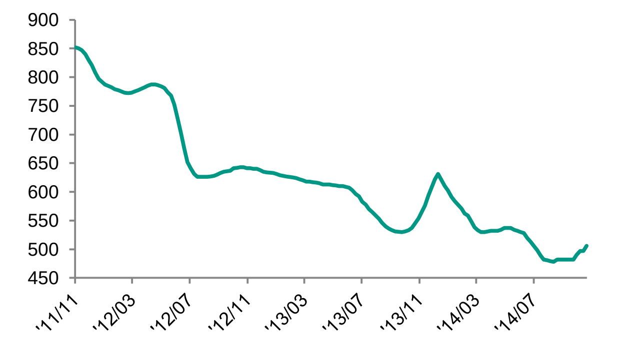
Yitai Coal (3984 HK, BUY). Yitai Coal's strength lies on its competitive unit cost (lowest among H-share peers) and high operation efficiency compared with the SOEs. Its present valuation is attractive at 1.01 FY15F P/B, considering its FY14F-16F ROE of ~12%. TP is set at HK$10.83.

China Coal (1898 HK, HOLD). The Group will benefit from reducing costs, sector restructuring, and increased government support. However, its low-single-digit ROE (3%-4%) justifies its deep discount to its book value (0.54 FY15F P/B). TP is set at HK$ 4.67.

Yanzhou Coal (1171 HK, SELL). Its current valuation is overly optimistic, considering its less-qualified coalmines and reducing demand from downstream sector and overseas markets. The stock is overvalued at present. We set our 12-month TP at HK$ 4.60.

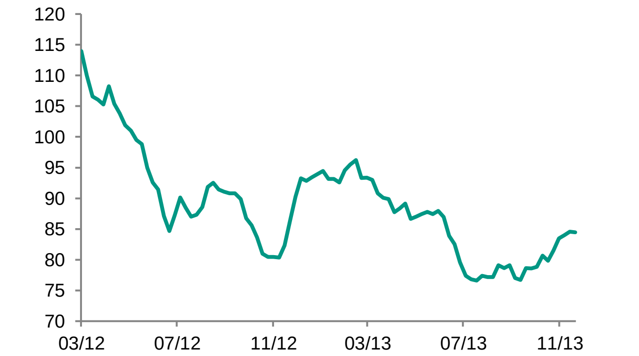
Risk factors: 1) Further declines in coal prices; 2) Supply-demand imbalance; 3) Business cycles of downstream industries; 4) Policy and regulation risks.

Exhibit 1: The Bohai-Rim thermal coal prices are rebounding (RMB/ton)



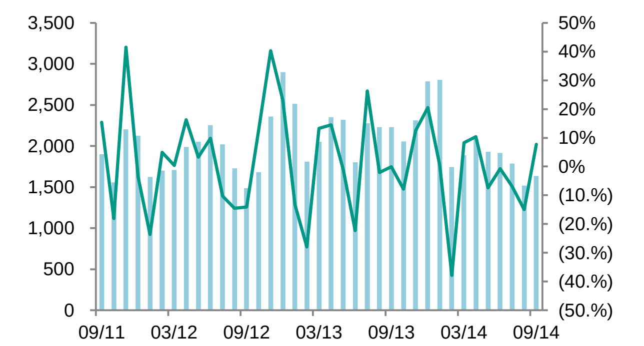
Source(s): Wind, ABCI Securities

Exhibit 2: Australia BJ thermal coal price Index shows a mild recovery (US$/ton)



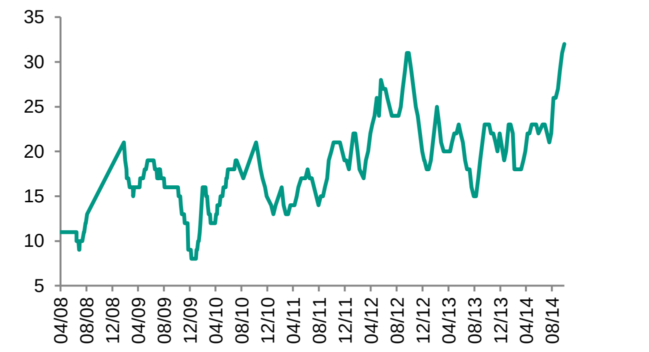
Source(s): Wind, ABCI Securities

Exhibit 3: Import coal (10kt) and MoM growth (%)



Source(s): Wind, ABCI Securities

Exhibit 4: Coal inventory days at major IPPs (day)



Source(s): Wind, ABCI Securities

Sector Valuation Summary (Data as of Nov 28, 2014)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY14F P/E(x)	FY15F P/E (x)	FY14F P/B (x)	FY15F P/B (x)	FY14F Yield (%)	FY15F Yield (%)
China Shenhua	1088 HK	BUY	24.90	12.93	9.56	8.75	1.30	1.19	3.85	4.20
China Coal	1898 HK	HOLD	4.67	(3.51)	52.92	16.11	0.56	0.54	0.54	2.16
Yanzhou Coal	1171 HK	SELL	4.60	(30.41)	14.60	15.20	0.44	0.43	1.92	1.92
Yitai Coal	3948 HK	BUY	10.83	12.00	11.04	10.01	1.23	1.14	2.75	3.04

Source(s): Bloomberg, ABCI Securities estimates

Looming challenges

- Raw milk price in China would continue to decrease until end-2015, when a rebound may occur and price would increase gradually in 2016
- We expect downward pressure in raw milk price and the intensified competition would lead to a new round of industry consolidation
- We prefer big players. Our 2015-16 outlook for Mengniu (2319 HK) is moderately optimistic based on its market leadership and consistent track record

Dairy Sector

Neutral

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2015-16 Outlook: looming challenges. We believe heightening competition in the Chinese dairy sector points to a tougher market in 2015-16. We expect raw milk price will continue to trend down and bottom out by end-2015. As for downstream products, we expect prices would continue to rise and competition would intensify. As a result, we believe an industry consolidation is likely to occur. In our view, established national brands and regional players with integrated production processes would have a better chance of weathering these challenges.

Raw milk price: the trough is yet to come. Raw milk price in China has been falling since the beginning of 2014 from 4.27 yuan/kg to 3.84 yuan/kg in Nov. We believe the downtrend in raw milk price is mostly caused by the declining international milk formula price that has dropped ~60% since their peak in Apr 2013. Many dairy product manufacturers have shifted to use milk formula as a result. The external downward pressure has not shown any sign of subsiding. Therefore, we expect raw milk price in China would continue to decrease until end-2015 and rebound gradually in 2016.

Increases in competition and retail prices of dairy products.. Big, national players would get bigger as they continue to enjoy vast distribution network and large-scale production; nevertheless, the regional players would also be able to capitalize on their geological advantages to target certain product segments such as pasteurized milk and yogurt. Although competition is stiffening, we expect retail prices of the current dairy products to rise on consumers' preference for higher-priced products. Efforts to promote consumption of premium products would also sustain the price rise.

Industry consolidation is expected. We expect downward pressure in raw milk price and the intensified competition would lead to a new round of industry consolidation. Raw milk supply may tighten on falling prices. The established national dairy players and regional players with integrated production processes would be immune from the downstream competition. We expect a new round of M&A activities would take place in 2015.

Favor big players. We prefer big players. Our 2015-16 outlook for Mengniu (2319 HK) is moderately optimistic based on its market leadership and consistent track record. Our main concern lies on its product portfolio that biases toward liquid milk products. Its main competitor, Yili (600887 CH), has successfully diversified away from the category. We maintain our **HOLD** rating for Mengniu with TP at HK$ 40.8.

Risk factors: 1) Product safety risk; 2) Herd and dairy farm management risk; 3) Policy risk, 4) Business partnership execution risk.

Key Data

Avg.15E P/E (x)	12.24
Avg.15E P/B (x)	1.78
Avg.15E Dividend Yield (%)	1.74

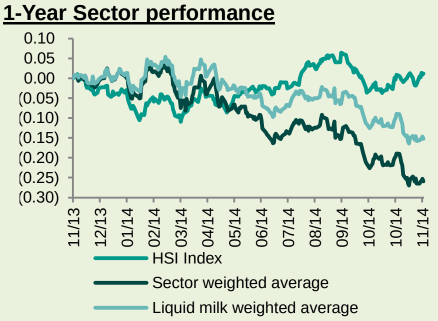
Source(s): Company, Bloomberg, ABCI Securities estimates

Sector performance (%)

	Absolute	Relative*
1-mth	(10.03)	(14.39)
3-mth	(22.24)	(22.67)
6-mth	(35.38)	(43.49)

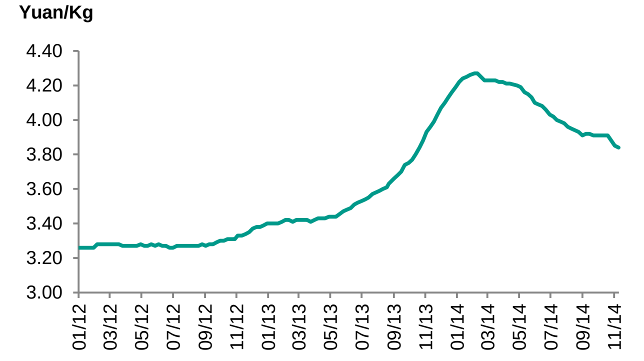
* Relative to Hang Seng Index
Source(s): Bloomberg, ABCI Securities

1-Year Sector performance



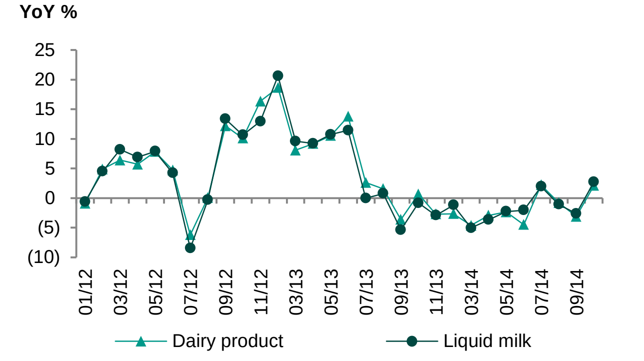
Source(s): Bloomberg

Exhibit 1: Raw milk price in China



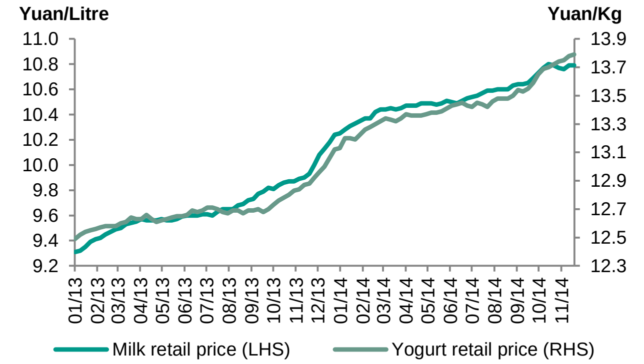
Source(s): Wind, ABCI Securities

Exhibit 2: Production volume growth of dairy product and liquid milk in China



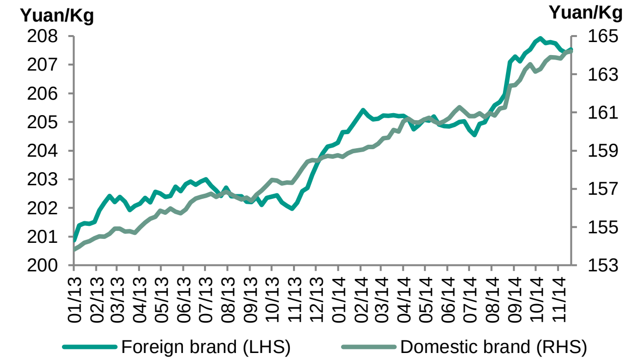
Source(s): Wind, ABCI Securities

Exhibit 3: Milk and yogurt retail price in China



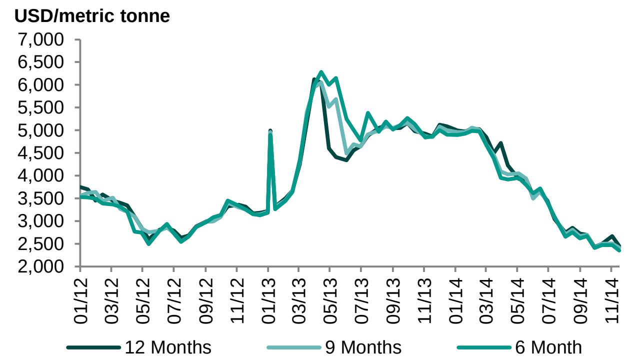
Source(s): Wind, ABCI Securities

Exhibit 4: Infant milk formula price in China



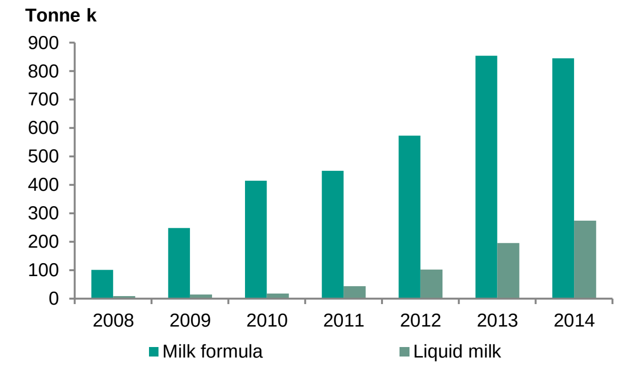
Source(s): Wind, ABCI Securities

Exhibit 5: New Zealand whole milk powder futures price



Source(s): Bloomberg, ABCI Securities

Exhibit 6: Import volume of dairy product in China



Source(s): Wind, ABCI Securities

Sector Valuation Summary (Data as of Nov 28, 2014)

Company	Ticker	TP (HK$)	Mkt Cap (HK$ mn)	Price return (%) 3 Mth	Price return (%) YTD	P/E (x) FY14E	P/E (x) FY15E	EPS growth FY14E	EPS growth FY15E	ROAE FY14E	ROAE FY15E
Mengniu Dairy	2319 HK	40.8	61,593	(11.28)	(14.54)	31.14	22.96	13.48	35.64	11.53	12.56
Huishan Dairy	6863 HK	--	23,418	(9.44)	(41.79)	12.54	10.17	3.00	23.30	11.01	12.43
Modern Dairy	1117 HK	--	12,068	(34.04)	(40.48)	9.39	7.71	214.93	21.80	16.56	17.37
Yuanshengtai	1431 HK	--	3,401	(36.03)	(60.99)	5.99	4.89	30.68	22.61	10.53	11.64
Shengmu Organic	1432 HK	--	15,187	(2.45)	0.00	17.22	11.27	N/A	52.73	25.80	25.23
Biostime	1112 HK	--	11,238	(36.14)	(73.02)	13.33	12.51	(19.64)	6.54	26.45	25.31
Yashili	1230 HK	--	8,364	(9.62)	(50.53)	18.08	16.05	(16.94)	12.62	11.03	11.98

Source(s): Bloomberg, ABCI Securities estimates

Improving sector fundamentals

- Strong VNB growth is expected to sustain in 2015 given the stronger focus on higher-margined protection-type products
- Interest rate cut provides a boost to the A-share market, favoring insurers' investment income
- Remain cautious on P&C underwriting cycle outlook given uncertainties entailed in the price deregulation of auto insurance and intensified competition
- We are positive on China's insurance sector and prefer life insurers over the P&C ones

Insurance Sector

Overweight

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Key Data

Avg.15F P/E (x)	13.56
Avg.15F P/B (x)	1.92
Avg.15F Dividend Yield (%)	1.67

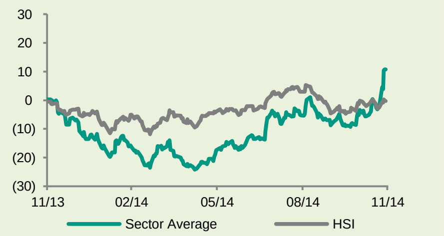
Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

	Absolute	Relative*
1-mth	17.63	15.64
3-mth	15.17	19.86
6-mth	34.03	30.11

* Relative to HSI
Source(s): Bloomberg, ABCI Securities

1-Year Sector performance (%)



Source(s): Bloomberg, ABCI Securities

High VNB growth. Chinese insurers delivered strong value of new business (VNB) growth in 1H14 (5.9%-44.0% YoY), primarily driven by strong agency VNB and recovery in first-year premium (FYP) annualized premium equivalent (APE). Agency VNB made up 84.4%-97.5% of total VNB for most insurers (except PICC Group: 32.7%). Given the continuous improvement in agent productivity, gradual expansion in agent force, increasing focus on higher-margined protection-type products and improving product mix, we expect robust VNB growth to sustain in 2015.

Key beneficiary of interest rate cut. Chinese insurers may benefit from the interest rate cut in China because: 1) the cut may lower the return on banks' wealth management products, raising the appeal of life insurance products; 2) interest rate cut enhances investors' confidence and improves sentiment in the A-share market, boosting equity market performance and elevating insurers' investment income.

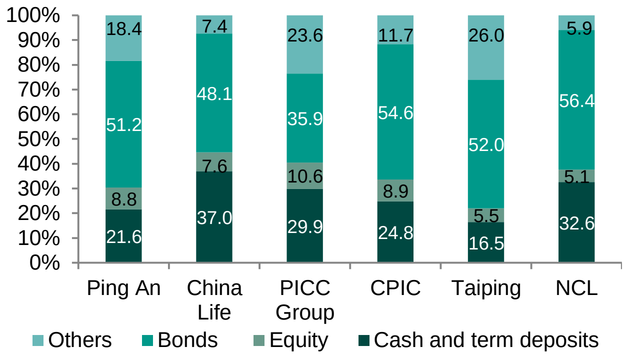
Combined ratio stabilized for P&C sector. Combined ratio stabilized in FY14 on lower catastrophe claims and improved cost controls, and we expect a similar ratio for FY15. We remain cautious on the P&C underwriting cycle outlook on uncertainties brought by the price deregulation of auto insurance and intensified competition in agriculture insurance that may drag down profitability.

Diversifying investment channels. Given the relaxation in investment channels, the Chinese insurers continue to increase investments in non-standard assets, including wealth management products, trust products, and investment properties to enhance recurrent investment yields and improve asset-liability management. We believe the overall risks are manageable under the strict supervision at present; fixed maturity investment still accounts for more than 70% of most insurers' asset mix. We expect growth in non-standard assets investment to continue in 2015.

Positive on China's insurance sector. The State Council issues new guideline to accelerate insurance development with specified goals: 1) insurance penetration (premium/GDP) will reach 5% (2013: 3.02%); 2) insurance density (premium/total population) will reach RMB 3,500/person (2013: RMB 1,266/person) by 2020. We are positive on China's insurance sector given its recovering fundamentals and policy support. We prefer life insurers over P&C ones on better outlook in the former.

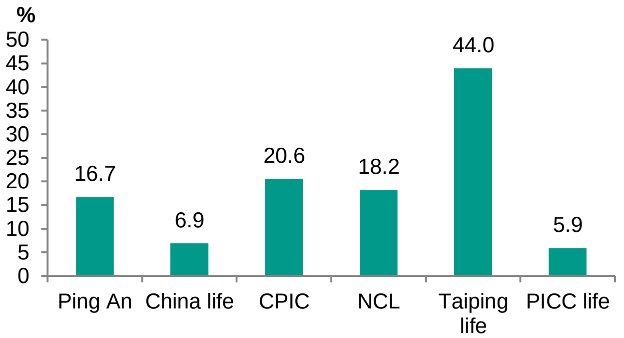
Risk factors: 1) Sharp deterioration in A-share market performance; 2) Slowdown in China's economic growth; 3) Lower-than- expected VNB and EV growth; 4) Increasing exposure to non-standard assets may elevate insurers' risk.

Exhibit 1: Insurers' investment portfolio in 1H14



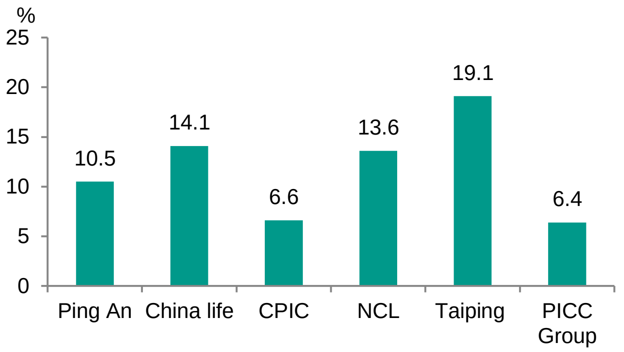
Source(s): Company, ABCI Securities

Exhibit 2: VNB YoY growth in 1H14



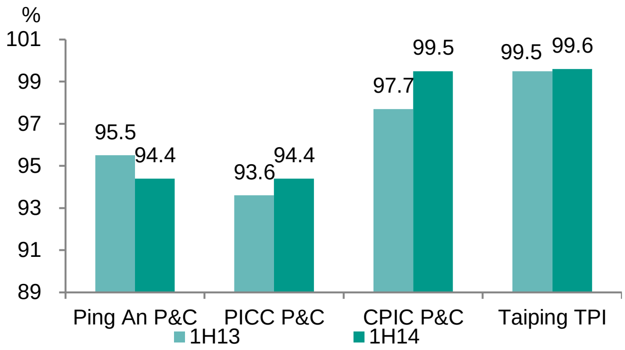
Source(s): Company, ABCI Securities

Exhibit 3: Insurers' EV growth in 1H14



Source(s): Company, ABCI Securities

Exhibit 4: Combined ratio of the Chinese insurers



Source(s): Company, ABCI Securities

Sector Valuation Summary (Data as of Nov 28, 2014)

Company	Ticker	FY14F P/E(x)	FY15F P/E (x)	FY14F P/B (x)	FY15F P/B (x)	FY14F Yield (%)	FY15F Yield (%)
China Pacific	2601 HK	20.16	16.89	2.13	1.93	1.62	1.86
Ping An Insurance	2318 HK	11.22	10.01	1.85	1.60	1.36	1.60
PICC Group	1339 HK	12.75	10.67	1.53	1.34	0.33	0.43
China Taiping	0966 HK	13.27	13.50	1.55	1.40	-	-
New China Life	1336 HK	12.66	11.46	1.92	1.67	0.93	1.06
China Life	2628 HK	18.51	15.79	2.48	2.21	1.64	1.88
PICC P&C	2328 HK	13.99	12.83	2.59	2.29	2.30	2.62

Source(s): Bloomberg, ABCI Securities estimates

The worst has been over

- Oct presales among major developers increased 17% YoY on continuous policy relaxation; low base in 2014 should provide additional boost to presales growth in 2015
- Increasing offshore bond issuance from A-share developers following the official launch of SH-HK stock connect will ease borrowing
- CSC (1668 HK) is our top commercial pick given its solid progress in e-commerce; we also favor tier-1 players benefiting from mortgage easing, such as Sunac (1918 HK) and CIFI (884 HK)

China Property Sector

Overweight

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Key Data

Avg.15F P/E (x)	4.61
Avg.15F P/B (x)	0.70
Avg.15F Dividend Yield (%)	6.51

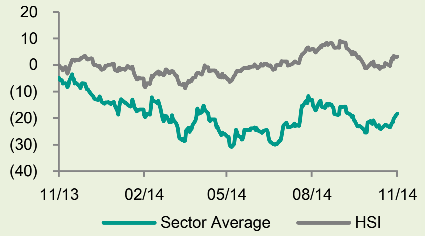
Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

	Absolute	Relative*
1-mth	9.93	7.94
3-mth	(0.07)	4.62
6-mth	11.60	7.68

* Relative to HSCEI
Source(s): Bloomberg, ABCI Securities

1-Year Sector performance (%)



Source(s): Bloomberg, ABCI Securities

Policy easing to continue. Following relaxation of the home purchase restriction (HPR), the government announced to ease mortgage lending by lowering down-payment and mortgage rate to 0.7x PBOC rate in Sep. The impact was immediate, as reflected by the 17% YoY rise in presales among major Chinese developers in October. We believe the policy will stay loose in the next 12 months until a solid uptrend appears.

Presales figures should rebound in 2015 on low-base effect. In 10M14, China's new home sales declined by 10% YoY to RMB 464bn; however, Oct figures fell only by 3% YoY, the slowest decline in 2014. We believe the property market has already bottomed out in 3Q14, as reflected by the consistent improvement since July (Jul: -18%; Aug: -14%; Sep -10%; Oct: -3%). We expect presales to expand by 10% YoY in 2015F due to the low base in 2014. Nonetheless, ASP would remain flat in 2015 on developers' efforts to reduce inventories.

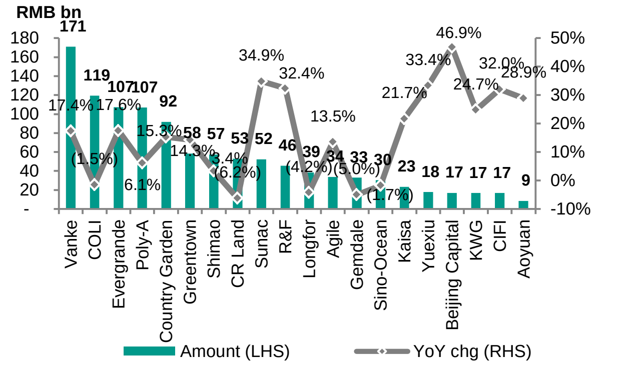
SH-HK stock connect encourages more A-share developers to issue offshore bond. The stock connect opens up a new channel for foreign investors to invest in A-share as well as offshore bond market in Hong Kong. Financial Street (000402 CH), an A-share commercial building developer, announced its plan to issue US$ 350mm bond via its Hong Kong subsidiaries on Nov 14 2014–three days before the launch of the stock connect. Cheap funding cost offshore will ease the tight borrowing environment straining developers in China.

Prefer tier-1 players and names that benefit most from recent rate cut. On Nov 21 2014, PBOC surprised the market by announcing the 40bps rate cut. For a RMB 1mn mortgage loan with a 20-year term, the monthly mortgage payment should be reduced by RMB 200 per month from RMB 7,200/mth to RMB 7,000/mth. We prefer Sunac (1918 HK) and CIFI (884 HK) based on their high exposure in tier-1 cities where mortgage buyers represent ~80% of total homebuyers, compared to 50% in lower-tier cities. We also expect players with a high gearing that have significant onshore bank borrowing to outperform because of the reduced interest expenses. Evergrande (3333 HK), whose gross interest expenses were the highest in the sector at RMB 8.1bn, should enjoy the most from finance cost saving.

CSC (1668 HK), a genuine O2O developer in the Internet era, is our top commercial pick. Since Tencent's strategic investment in the group in Jan 2014, CSC had made major strides in its e-commerce business, whose revenue reached HK$ 189mn in FY14. The group recently strengthened its B2B platform by acquiring Makepolo in Sep 2014. In our view, CSC's segment-specific penetration strategy in major B2B products (e.g. furniture, electronics, textiles, etc.) may replicate the success of JD.com, China's leading online 3Cs retailers with a market cap of US$ 33.9bn, which is 10 times larger than that of CSC. Following a specialization strategy, CSC's online platform should warrant a premium valuation as market share rises.

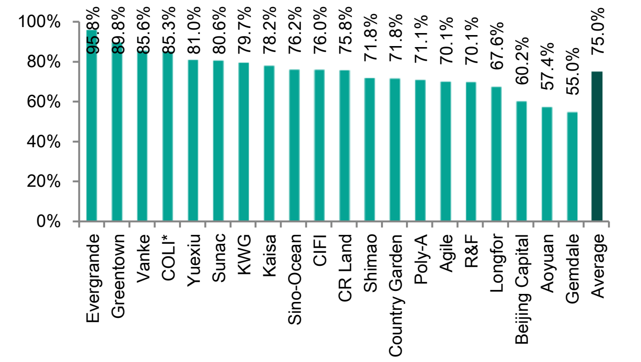
Risk factors: 1) Intensifying competition for land; 2) Aggressive price cut to clear inventories may hurt margins; 3) Litigation risks related to improper land acquisitions.

Exhibit 1: 10M14 presales



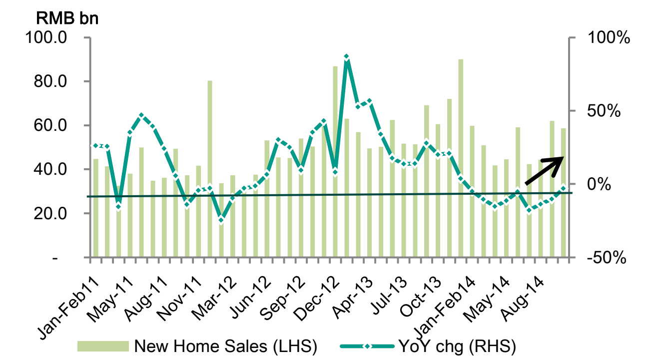
Source(s): Companies, ABCI Securities

Exhibit 2: Sales target completion ratio as at Oct 2014



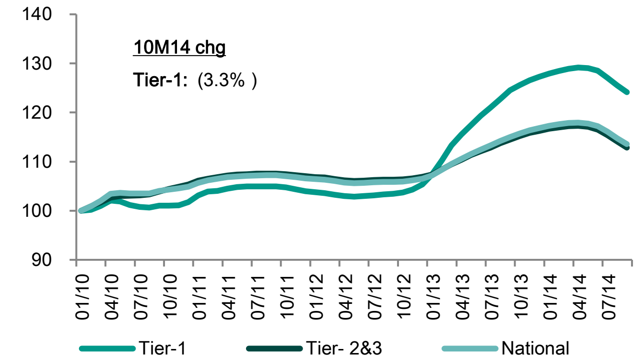
Source(s): Companies, ABCI Securities

Exhibit 3: New home sales in China



Source(s): NBS, ABCI Securities

Exhibit 4: Property price of 70 major cities for new homes (Jan 2010=100)



Source(s): NBS, ABCI Securities

Sector Valuation Summary (Data as of Nov 28, 2014)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY14F P/E(x)	FY15F P/E (x)	FY14F P/B (x)	FY15F P/B (x)	FY14F Yield (%)	FY15F Yield (%)
Sunac	1918 HK	BUY	9.80	36%	4.0	3.9	1.1	0.9	4.5	4.7
CIFI	884 HK	BUY	2.30	49%	3.9	3.3	0.7	0.6	5.7	6.7
Aoyuan	3883 HK	BUY	2.50	95%	3.3	2.1	0.3	0.3	7.6	11.9
Kaisa	1638 HK	BUY	5.00	67%	4.2	3.7	0.7	0.6	5.3	7.3
Evergrande	3333 HK	BUY	3.80	21%	4.7	3.1	0.4	0.4	6.8	7.7
CSC	1668 HK	BUY	4.60	15%	9.2	6.6	1.4	1.3	4.8	6.0
Greentown	3900 HK	HOLD	8.50	9%	3.8	3.9	0.5	0.5	6.9	6.4
COLI	688 HK	HOLD	23.70	2%	8.2	7.1	1.5	1.3	2.4	2.8
Franshion	817 HK	HOLD	2.10	-9%	6.8	5.8	0.7	0.6	5.5	7.3

Source(s): Bloomberg, ABCI Securities estimates

"New Silk Road" to propel growth

- We assign an **OVERWIEGHT** rating for the railway sector on the expected increase in overseas contract flow from China's New Silk Road" strategy
- The introduction of Railway Development Fund would improve financing for domestic railway project
- Favor leading railway players with exposure in overseas market. Recommend **BUY** for CRCC, CRG, CSR and ZCSR

China's Marshall Plan. The "New Silk Road" strategy or the "One Belt and One Road" initiative was communicated by China in 2013 during President Xi Jinping's visit to Kazakhstan. China would offer technology and financial support for countries along the "Silk Road" to promote partnership and economic cooperation. President Xi also announced that China will establish a Silk Road Fund of US$ 40bn to support infrastructure investments in countries involved in the scheme. We expect a large amount of funding will be directed to the construction of transport infrastructure, power plants and telecom facilities. The overseas construction projects would be the growth driver of China's construction contractors in the next five years.

Domestic railway outlook 2015. According to CRC, 64 new projects would commence in 2014. We estimate the total investment of these projects, which are mostly located in Central and Eastern China, would be ~RMB 1,046bn. Major projects commenced include the railway from Inner Mongolia to Central China for coal transportation. Total length of the railway is ~1,800km, with an estimated total CAPEX of RMB 193bn. Other than rail freight transport, 4 passenger rail lines have started construction in 2014, which include the Shangqiu-Hangzhou Rail Line connecting Henan and Zhejiang, Wuhan-Shiyan Intra-provincial Rail Line in Hubei, Yinchuan-Xi'an Rail Line connecting Ningxia and Shaanxi, and Jinan-Qingdao Intra-provincial Rail Line in Shandong. We estimate the total investment on these rail lines to be ~RMB 283bn. The projects would provide support to the industry pipeline in 2015-16, enhancing the flow of new contracts as well as earnings visibility of the railway constructors and rolling stock manufacturers over the next few years. CAPEX growth of domestic railway transport segment would peak in 2014 and slow thereafter due to the high bases.

CRCC (1186 HK, BUY). We like its leading position in the railway construction industry and its expansion in overseas market. Total new overseas contracts in 9M14 amounted to RMB 16bn, or 20.3% of the company's new contract value, up from 9.4% in FY13.

CRG (390 HK, BUY). CRG is another major railway constructor in the duopolistic market in China. Although CRG's profit margins and asset return are lower than those of CRCC, its profitability has been improving under the SOE reform. CRG's 9M14 GPM was up 0.66ppt YoY to 7.81%. While CRCC has a higher ROE than CRG, the gap shrank from 2.3% in 9M13 to 1.2% in 9M14.

Railway Sector

Overweight

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Key Data

Avg.15F P/E (x)	10.56
Avg.15F P/B (x)	1.58
Avg.15F Dividend Yield (%)	2.12

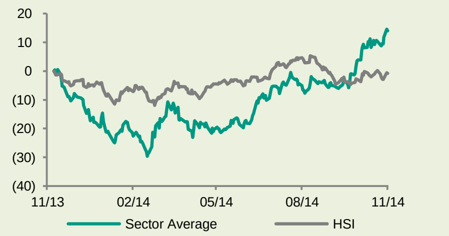
Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

	Absolute	Relative*
1-mth	6.31	4.93
3-mth	23.46	27.08
6-mth	43.19	40.20

* Relative to HSI
Source(s): Bloomberg, ABCI Securities

1-Year Sector performance (%)



Source(s): Bloomberg, ABCI Securities

CSR (1766 HK, BUY). With more high-speed railways operating in 2014-15 and the introduction of Railway Development Fund, the delivery of rolling stocks in 2015 is likely to be on schedule. Furthermore, with the new Silk Road Fund, CAPEX acceleration in the involved countries would offset the slowdown in domestic infrastructure investment in 2015E-20E. We expect market sentiment to stay bullish.

ZCSR (3898 HK, BUY). As the subsidiary of CSR supplying components for rolling stock electrical system, we believe the company's sales growth would be spurred by the increased demand for MUs and electrical locomotive in China. About 52.1% of all locomotives in China were electrical ones as of end-2013. The Chinese government targeted to increase the electrical ratio of rail lines to 60% by 2015 (end-2013: 54%). Besides, it is expected CSR and CNR (6199 HK) will cooperate to develop overseas business. Additional demand from overseas market would enhance the potential upside for this upstream supplier.

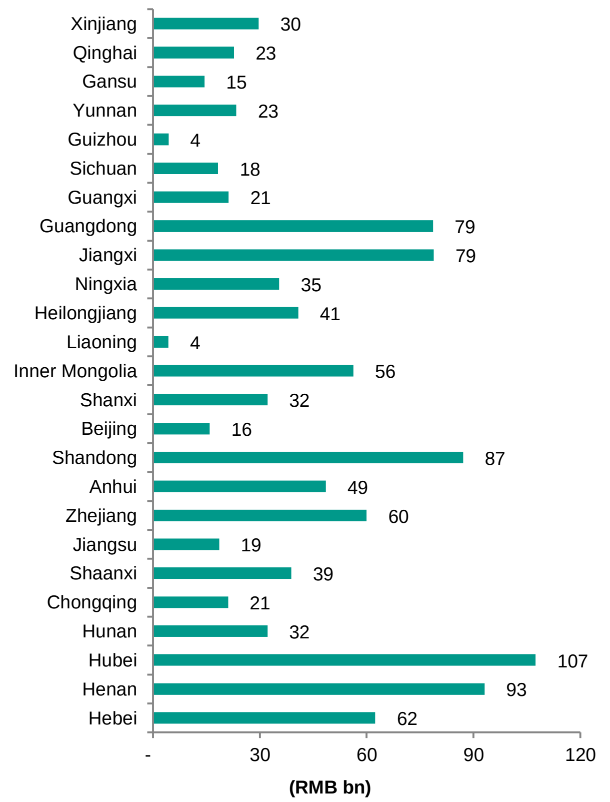
Risk factors: 1) Domestic railway investment is peaking off under high bases; 2) China's overseas expansion is subject to the political situations in the targeted countries; 3) Market competition from international/overseas constructors and rolling stock manufacturers.

Exhibit 1: The major rail lines planned/under construction in countries near China

Countries	Rail line	Designed Speed (km/h)	Length (km)
Middle-Asia			
Kazakhstan	Astana - Almaty	250	1,011
Asia			
India	Howrah - Haldia	300	135
	Delhi - Patna	350	991
	Delhi - Amritsar		450
	Delhi - Chennai	300	1,754
	Mumbai–Ahmedabad	320	534
	Chennai - Thiruvananthapuram	350	850
Indonesia	Jakarta-Surabaya	300	785
Singapore	Kuala Lumpur - Singapore	300	353
Malaysia	Kuala Lumpur - Penang		356
Pakistan	Peshawar - Karachi		1,340
Philippines	Laoag - Bicol		902
Thailand	Bangkok-Chiang Mai	250	745
	Bangkok-Nong Khai	250	625
	Bangkok-Ubon Ratchathani	250	610
	Bangkok-Rayong	250	178
	Bangkok-Padang Besar	250	990
Vietnam	Hanoi - Ho Chi Minh City	250	1,630
Africa			
Algeria	Tlemcen - Akkid Abbas	220	66
Morocco	Kenitra-Tangier high-speed rail line	320	200
South Africa	Johannesburg-Durban	240	721
	Total		**15,226**
	The planned new HSR delivery in 2015-20		**14,000**

Source(s): Media, ABCI Securities

Exhibit 2: Breakdown of new railway starts in 2014



Source(s): China Railway Tender, ABCI Securities estimates

Sector Valuation Summary (Data as of Nov 28, 2014)

Company	Ticker	Rating	TP (HK$)	Upside (%)	FY14F P/E(x)	FY15F P/E (x)	FY14F P/B (x)	FY15F P/B (x)	FY14F Yield (%)	FY15F Yield (%)
CRCC	1186 HK	BUY	10.29	17.74	7.49	6.65	0.99	0.88	2.00	2.26
CRG	390 HK	BUY	6.16	11.44	9.14	8.21	1.01	0.91	1.64	1.83
CSR	1766 HK	BUY	10.34	33.23	15.69	13.75	2.14	1.88	1.91	2.18
ZCSR	3898 HK	BUY	44.05	34.29	15.21	13.63	3.02	2.64	1.97	2.20

Source(s): Bloomberg, ABCI Securities estimates

What's hot in 2015: O2O application

- Well-developed MI apps and high penetration of smartphone enable traditional industries to leverage on MI to expand their businesses at a low cost
- Internet finance, O2O, triple play, big data & cloud related services will be the sector's hot spots
- We are optimistic on leading players. Recommend **BUY** for Tencent (700 HK); Alibaba (BABA US) and Baidu (BIDU US) also deserve close attention

China TMT Sector

Overweight

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O2O creates big business opportunities for internet companies by providing services to integrate traditional business with mobile internet (MI). After smartphone's explosive growth in 2013 and widespread development of mobile apps in 2014, traditional industries have more opportunities to leverage on mobile networks to extend and integrate their online and offline operations. We are optimistic on the commercial use of O2O, triple play, and business opportunities derived from big data and cloud computing services.

Mobile apps allow businesses to extend their access to more clients and markets. By June 30, 2014, the number of Chinese netizens reached 632mn; internet penetration rate was 46.9%, 1.1ppt higher than that at end-2013. The percentage of administrative villages with broadband coverage reached 92%. Smartphones' market share increased from 78% (by end-2013) to 84% (by Sep 30, 2014). Mobile broadband subscribers reached 525mn, surpassing the number of fixed-line broadband (200 million) user. These already high figures mean that the growth of internet users may slow.

Well-developed mobile apps have turned user-friendly, allowing businesses to extend access to more clients and markets. Internet companies have developed applications covering almost all industries including retail, dining, payment system, transportation, online education, logistics and internet finance. By providing sophisticated and valuable services to traditional sectors, internet companies are gradually increasing the ARPU value.

What are the hot spots? The application of O2O, internet finance (such as mobile payment), big data analysis and cloud computing services. Other sectors related to the above application (e.g. mobile ad. platform) will also benefit.

M&A will transfer from cross-border to industrial integration. The internet industry has a winner-takes-all feature. Successful O2O players will agglomerate large number of active users, which makes it difficult for others to compete with. Companies with a huge customer base have more "trial-and-error" opportunities to improve customer experience and enjoy greater monetization capacity. Instead, companies with weaker customer relations and smaller client bases will be marginalized or eliminated. Such trend will be more apparent in 2015 with the occurrence of more M&A activities that accelerate industry consolidation.

Positive sector outlook. Compared with previous years, we will see more well-developed MI solutions with mature features and stronger monetization; user demand will also be robust. All these will drive up the overall profit of the sector.

Key Data*

Avg.14F P/E (x)	16.61
Avg.15F P/E (x)	13.93
Avg.14F Dividend Yield (%)	1.69

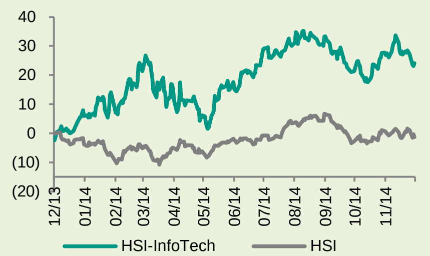
* Estimates are Bloomberg consensus
Source(s): Bloomberg, ABCI Securities

Sector performance (%)

	Absolute	Relative*
1-mth	7.25	(4.78)
3-mth	6.03	(8.13)
6-mth	(3.07)	(9.10)

* Relative to HSCEI
Source(s): Bloomberg, ABCI Securities

1-Year Sector performance (%)



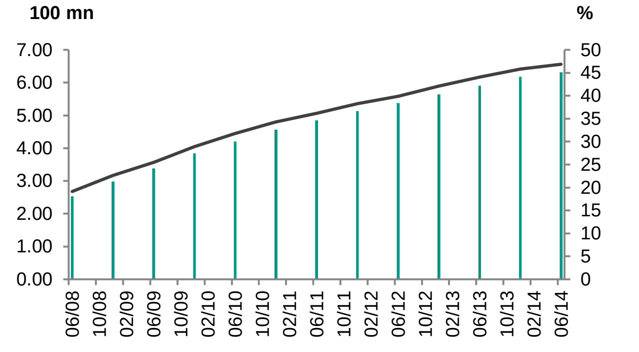
Source(s): Bloomberg, ABCI Securities

Recommend leading sector player. Recommend **BUY** for Tencent (0700 HK). We also favor Alibaba (BABA US) and Baidu (BIDU US). The three companies have established strong end-user/customer stickiness.

We expect the sector's net profit growth to be high in 2015 and this will support the leaders' high valuation.

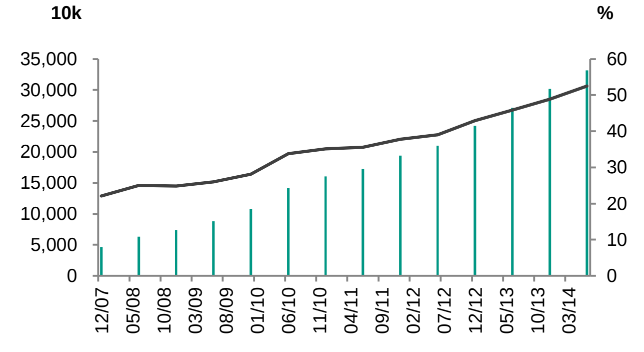
Risk factors: 1) Increased surveillance by government; 2) Intensified competition among mobile platforms reduce gross profit margin; 3) Technical or policy barriers hinder development of O2O application.

Exhibit 1: No. of China's internet users and internet penetration rate



Source(s): Wind, ABCI Securities

Exhibit 2: No. of people purchasing online and usage rate



Source(s): Wind, ABCI Securities

Sector Select Stocks' Valuation Summary (Data as of Nov 28, 2014)

Company	Ticker	Price*	TP**	Market Cap.	FY14F P/E (x)	FY15EF P/E (x)	FY14F PEG (x)	FY15F PEG (x)
ABCI Recommend	**(HK$)**							
Tencent	700 HK	124.00	153.00	1,161,548	38.32	29.27	1.14	0.87
Chinasoft Intl	354 HK	2.55	3.27	4,777.13	19.61	15.42	NA	NA
Hong Kong Market	**(HK$)**							
Tencent	700 HK	124.00	148.25	1,161,548	38.32	29.27	1.14	0.87
Boyaa	434 HK	6.61	8.64	5,002	13.06	9.55	NA	NA
Forgame	484 HK	15.08	15.10	1,916	NA	17.62	NA	NA
Netdragon	777 HK	13.00	16.92	6,618	15.35	14.54	NA	NA
Tiange	1980 HK	4.29	5.55	5,417	NA	13.43	NA	NA
Baioo	2100 HK	0.76	1.12	2,152	6.54	5.52	1.68	1.42
Kingsoft	3888 HK	18.58	21.81	22,008	25.68	20.38	NA	NA
Ourgame	6899 HK	3.86	5.15	3,026	14.09	9.07	NA	NA
Igg	8002 HK	3.37	4.42	4,614	9.66	7.90	0.17	0.14
Kingdee Intl	268 HK	2.54	3.16	6,536	22.60	18.12	NA	NA
Chinasoft Intl	354 HK	2.55	2.96	4,777	19.61	15.42	NA	NA
Chanjet	1588 HK	16.22	17.35	3,523	17.13	13.67	NA	NA
US Market	**(USD)**							
Alibaba Grp	BABA US	111.64	118.52	275,193	50.97	37.41	1.73	1.27
JD.Com Inc	JD US	23.52	32.68	32,154	NA	2293.20	NA	57.33
E-Commerce	DANG US	11.09	14.08	904	52.00	20.60	1.80	0.71
Jumei	JMEI US	18.50	22.76	2,648	32.92	22.32	0.48	0.32
Vipshop	VIPS US	22.86	26.59	12,919	80.78	45.63	1.01	0.57
Baidu	BIDU US	245.11	274.18	85,938	37.70	27.35	1.09	0.79
Sina	SINA	37.95	55.90	2,529	50.26	43.97	7.01	6.13
Sina	WB US	17.95	23.62	3,593	NA	68.77	NA	NA
Sohu	SOHU US	50.61	59.97	1,948	NA	NA	NA	NA
Netease	NTES US	105.67	104.16	13,809	17.08	14.46	1.49	1.26
Qihoo 360 Tech	QIHU US	74.33	111.71	9,360	32.08	19.88	0.92	0.57
58.Com	WUBA US	48.79	47.30	4,284	265.16	12197.50	3.60	165.50
Soufun	SFUN	8.74	11.87	3,608	15.80	14.62	NA	NA
Qunar	QUNR US	26.08	35.13	3,092	NA	NA	NA	NA
Youku	YOKU US	18.50	22.76	3,853	NA	NA	NA	NA
Tuniu	TOUR US	13.21	20.75	628	NA	NA	NA	NA
Ctrip.	CTRP US	54.08	62.38	6,999	80.48	57.90	2.64	1.90
Nq Mob	NQ US	7.02	33.00	434	5.95	4.23	NA	NA
51job	JOBS US	36.75	34.93	2,185	22.27	19.34	NA	NA

* All prices are based on the currency of the market.
** Based on Bloomberg target price except ABCI's recommendation
Source(s): Bloomberg, ABCI Securities estimates

Heading for healthy growth

- Regulatory policies will be released and eliminate uncertainty of the sector
- We expect mobile payment usage will increase on intensified O2O application and smartphone penetration
- P2P/crowdfunding platforms may entail higher entry barrier in the future due to interest rate reform and tightened regulations

Internet Finance

Overweight

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Key Data*

Avg.14F P/E (x)	26.38
Avg.15F P/E (x)	18.73
Avg.15F Dividend Yield (%)	0.70

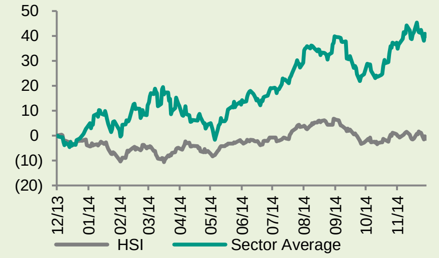
* Estimates are Bloomberg consensus
Source(s): Bloomberg, ABCI Securities

Sector performance (%)

	Absolute	Relative*
1-mth	5.63	4.42
3-mth	5.86	8.91
6-mth	20.42	16.62

* Relative to HSI
Source(s): Bloomberg, ABCI Securities

1-Year Sector performance (%)



Source(s): Bloomberg, ABCI Securities

Internet finance (IF) entails huge demand and great potentials. Flourishing e-commerce, online games, and O2O businesses have spurred huge demand for mobile payments, online trading, online investment and related online financial services. The popularity of smartphones and expansion of 4G network further increase the penetration of mobile payment to social lives, accelerating IF's development in 2015.

Online finance platform (P2P and crowdfunding) will continue to grow. Financing demand by China's private firms is huge, but China's lack of free interest rate market and inefficient credit system make due diligence highly difficult and expensive. SOE banks are reluctant to provide loans to private firms, especially the micro and small enterprises (MSEs) accounting for ~94.15% of the total companies. Premier Li Keqiang urged banks to ease financing costs in the State Council meeting on Nov 19, followed by announcement of central bank's interest rate cut. However, the SOE banks may still feel reluctant to increase loans to MSEs, partly due to the inefficiency of the present credit system. We believe this situation is unlikely to change in 2015, which will provide a good opportunity for IF platforms that have been actively lending to small firms at a higher interest rate.

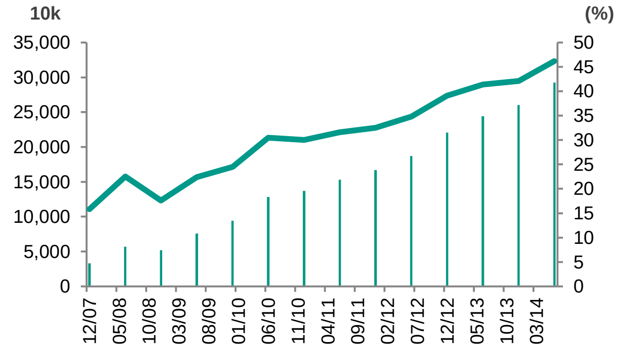
IF continues to benefit from national policies. This belief is based on the State Council meeting on Nov 19, which: 1) explicitly encouraged the setup of private banks and small private financial institutions; 2) urged large banks to provide multi-level financial services in communities, micro-branches and mobile banks; 3) encouraged IF to provide better financial services for MSEs. These initiatives actually assure the official status of IF as a useful complement of traditional finance.

2015 is a regulatory year. China is expected to introduce official rules on IF platforms such as P2P/crowdfunding. While it improves IF's entry barrier, it also eliminates policy uncertainties, leading to a more healthy growth of IF and providing greater room for prudent operations. It also helps prevent fraudulent P2P platforms.

We favor Internet companies with large client base and sound financials. Recommend Tencent (0700 HK), which will commence its internet banking business soon. Its O2O and third-party payment ecosystems are growing quickly. IF business is expected to be a new earnings driver for Tencent in the coming years. Other focuses include Alibaba (BABA US) and Baidu (BIDU US), which have sound third-party payment resources, online investment, and large customer bases.

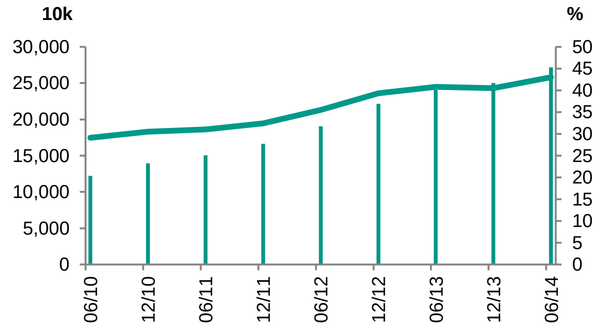
Risk factors: 1) Interest rate reform, if accelerated, may negatively affect the P2P/crowdfunding platforms; 2) Collapse of China's shadow banking system; 3) Intensifying competition from non-bank financial institutions.

Exhibit 1: No. of people using online payment and usage rate



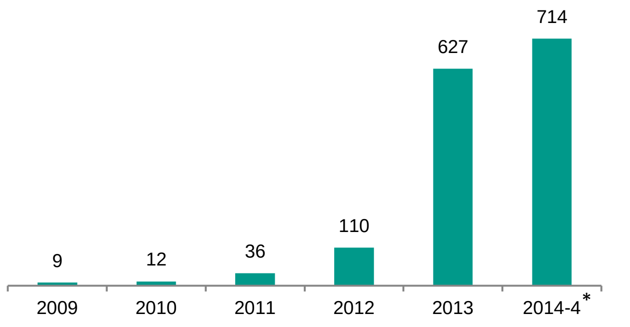
Source(s): Wind, ABCI Securities

Exhibit 2: No. of people using online banking service and usage rate



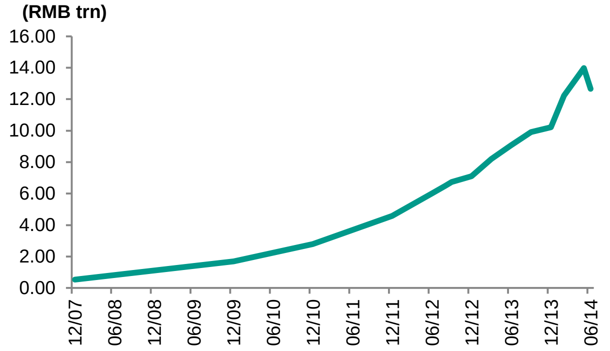
Source(s): Wind, ABCI Securities

Exhibit 3: No. of China's P2P platforms is growing fast



*4M14 data
Source(s): Wind, ABCI Securities

Exhibit 4: Aggregated balance of the financial products in China's banking system



Source(s): Wind, ABCI Securities

Sector Valuation Summary (Data as of Nov 28, 2014)

Company	Ticker	Price	Target Price*	Market Cap.	FY14E P/E (x)	FY15E P/E (x)	FY14E PEG (x)	FY15E PEG (x)
ABCI – Coverage								
Tencent	0700 HK	124.00	153	1,161,548	38.32	29.27	1.14	0.87
ChinaSoft Int'l	0354 HK	2.55	3.27	4,777	19.61	15.42	NA	NA
HK IF Concept (HKD)								
Tencent	0700 HK	124.00	148.25	1,161,548	38.32	29.27	1.14	0.87
Chinasoft Int'l	0354 HK	2.55	2.96	4,777	19.61	15.42	NA	NA
PAX Global	0327 HK	8.53	9.80	9,387	23.09	18.50	NA	NA
Kingdee Int'l	0268 HK	2.54	3.16	6536.33	22.60	18.12	NA	NA
Citic Bank	0998 HK	5.77	5.08	347,033	5.05	4.68	0.29	0.27
Cm Bank	3968.HK	16.06	17.03	399,345	5.41	4.92	0.55	0.50
Ping An	2318.HK	65.05	84.91	507,059	11.44	10.29	0.71	0.64
Credit China	8207 HK	1.91	2.10	6,152	56.03	22.58	1.35	0.54
China Smartpay	8325 HK	1.26	NA	1,306	NA	NA	NA	NA
Econtext Asia	1390 HK	2.80	4.10	1,453	20.00	17.50	NA	NA
US Market (USD)								
Alibaba	BABA US	111.64	118.52	275,193	50.97	37.41	1.73	1.27
Baidu	BIDU US	245.11	274.18	85,938	37.70	27.35	1.09	0.79

*Bloomberg target price except for the ABCI estimates.
Source(s): Bloomberg, ABCI Securities estimates

High growth potential

- Thanks for the rapidly expanding 4G/LTE network, broadband coverage, and higher penetration of smartphones, mobile game is getting more popular with mobile users
- Internet infrastructure will be greatly enhanced in 2015, forming a solid foundation for the mobile game sector
- Favor sector players with strong distribution channels, operation capacity or R&D capability. Recommend **BUY** for Tencent (700 HK)

Mobile Game

Overweight

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We predict China's mobile game market to reach RMB25-30bn in 2014. The sector is still in its early stage of development, esp. in product design, display modes and interaction methods.

There are 3 catalysts for the mobile game sector: growing number of mobile game users, fee-based clients and higher ARPU value growth. Thanks to the rapidly expanding 4G/LTE network, broadband coverage, and growing penetration of smartphones, mobile game is getting more popular with mobile users.

Smartphone replacement in 4Q14. As prices of large-screen 4G handsets decline with more supplies entering the market, the product becomes more widely used in the country, laying the foundation for further penetration of mobile internet applications. Smartphone replacement and upgrade also allow games with higher ARPU value to be easily transferred from PC to mobile devices.

Mobile game market continues to grow after penetration peaks. Though revenue growth of new mobile game players will gradually weaken in the next 2 years, new games, new media, new accessories and new technologies are emerging. These are important driving forces of higher ARPU and monetization.

Infrastructure will be greatly enhanced in 2015, forming a solid foundation for the mobile game sector. China's telecom operators accelerated the 4G base station construction in 2014 and coordinate with smartphone suppliers, making it possible for 4G users to enjoy cheaper phones with more favorable 4G plans. Meanwhile, internet giants such as Tencent (0700 HK), Alibaba (BABA US) and Baidu (BIDU US) are promoting the nationwide free WiFi network. All these will be positive to the development of mobile games in China.

Distribution and payment channel fees expected to reduce. In China, there are various distribution/download channels and payment channels for mobile games. Tencent is now the dominant distribution/download platform. The huge MAU and stickiness of Tencent's clients largely reduce the threat posed by price competition. The availability of other distribution channels, however, helps lower the distribution costs for some successful game operators. This trend may become more apparent in 2015. Expansion of third-party payment firms and fierce competition among operators enhance the bargaining power of mobile game companies. The cost of payment channels is expected to further decline in 2015, which helps increase the net income of mobile game companies .

Key Data*

Avg.14F P/E (x)	17.53
Avg.15F P/E (x)	14.14
Avg.14 Dividend Yield (%)	0.68

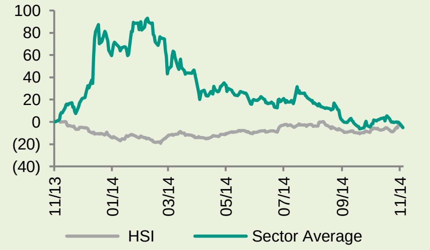
* Estimates are from Bloomberg.
Source(s): Bloomberg, ABCI Securities

Sector performance (%)

	Absolute	Relative*
1-mth	1.97	0.01
3-mth	(12.07)	(7.52)
6-mth	(15.59)	(18.51)

* Relative to HSCEI
Source(s): Bloomberg, ABCI Securities

1-Year Sector performance (%)



Source(s): Bloomberg, ABCI Securities

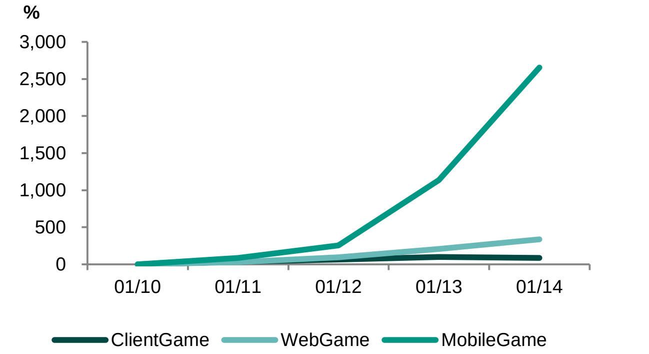
New techs and media will make a major breakthrough for mobile game products. Many mobile game companies are redesigning their games to covert PC gamers into mobile ones. Although it would take longer for such products to develop, a successful mobile game could drive up profits substantially.

Stock picks: Favor those with strong distribution channels, operation capacity or R&D capability. Recommend BUY for Tencent (0700 HK). We also favor Kingsoft (3888 HK) for its strong product development capability and its close relationship with Xiaomi, one of the most popular mobile producers in China. Also noteworthy are Dreamsky (DSKY US), which has strong distribution channels, and IGG (8002 HK), which has a strong foothold in overseas market.

Valuation adjustments are in place. Share prices of Hong Kong's mobile game developers have seen significant correction in 2014. Considering the emerging positives in 2015, we believe the sector to outperform the market.

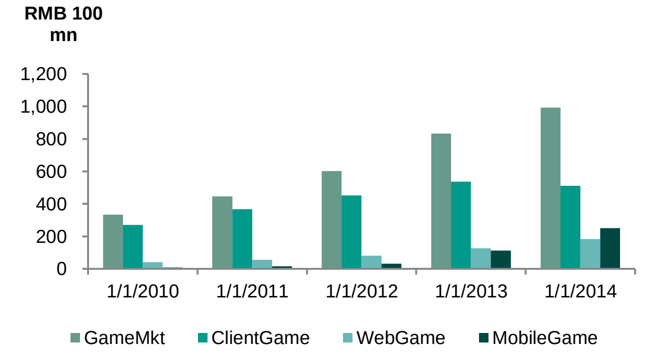
Risk factors: 1) Intensified industrial competition; 2) Product failure; 3) Risks of policies and regulations.

Exhibit 1: Sales growth by game type (base year: 2011)



Source(s): Wind, ABCI Securities calculations

Exhibit 2: Sales of different game types in China



Source(s): Wind, ABCI Securities calculations

Sector Valuation Summary (Data as of Nov 28, 2014)

Company	Ticker	Price	Target Price*	Upside (%)	Mkt Cap (mn)	FY14E P/E(x)	FY15E P/E (x)	FY14E PEG(x)	FY15E PEG (x)
Hong Kong (HK$)									
Tencent	0700.HK	124.00	153	23.39	1,161,548	38.32	29.27	1.14	0.87
Boyaa	0434.HK	6.61	8.64	30.71	5,002	13.06	9.55	NA	NA
Forgame	0484.HK	15.08	15.10	0.13	1,916	NA	17.62	NA	NA
Netdragon	0777.HK	13.00	16.92	30.17	6,618	15.35	14.54	NA	NA
Tiange	1980.HK	4.29	5.55	29.46	5,417	NA	13.43	NA	NA
Baioo	2100.HK	0.76	1.12	46.71	2,152	6.54	5.52	1.68	1.42
Kingsoft	3888.HK	18.58	21.81	17.40	22,008	25.68	20.38	NA	NA
Ourgame	6899.HK	3.86	5.15	33.42	3,026	14.09	9.07	NA	NA
IGG	8002.HK	3.37	4.42	31.22	4,614	9.66	7.90	0.17	0.14
U.S (US$)									
CMGE	CMGE.O	25.58	29.67	15.98	805	19.09	11.06	NA	NA
Changyou	CYOU.O	23.20	21.26	(8.36)	1249	NA	23.75	NA	NA
iDreamSky	DSKY.O	21.24	28.50	34.18	899	NA	11.33	NA	NA
PerfectWorld	PWRD.O	18.25	25.64	40.49	904	9.10	8.09	NA	NA
Taomee	TAOM.N	3.99	4.00	0.25	143	199.50	30.69	NA	NA
YY	YY.O	76.45	104.75	37.01	4326	26.84	19.26	NA	NA
SNDA	GAME.O	6.55	NA	NA	1761	NA	NA	NA	NA

* Based on Bloomberg consensus except for Tencent
Source(s): Bloomberg, ABCI Securities estimates

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Disclosures of Interests

ABCI Securities Company Limited and/or its affiliates, within the past 12 months, have investment banking relationship with one or more of the companies mentioned in the report.

Philip Chan holds H-shares of Agricultural Bank of China Ltd (1288 HK）.

Pandora Leung holds H-shares of Forgame Holdings Ltd. (484 HK), Link REIT (823 HK) and China Telecom Corp. Ltd. (728 HK).

Definition of equity rating

Rating	Definition
Buy	Stock return ≥ Market return rate
Hold	Market return – 6% ≤ Stock return < Market return rate
Sell	Stock return < Market return – 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months
Market return: 5-year average market return rate from 2009-2013
Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	2.6 ≤180 day volatility/180 day benchmark index volatility
High	1.5 ≤ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	1.0 ≤180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.
Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price
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