ABCI China /Hong Kong Equity Research
2016 Economic Outlook & Investment Strategy

Prosperity in the Making

農銀國際
ABC INTERNATIONAL
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Published on Dec 11, 2015
Data as of Dec 3, 2015 unless otherwise specified

2016 Global Economic Outlook and Strategies: A bird's eye view

2016 Outlook in Brief

- In 2016, the U.S. will enjoy a stable recovery. Strength of the USD may curb substantial rebound in economic activities but help offset the inflation pressure. Normalization of monetary policy through rate hikes will continue to increase economic momentum; abundant liquidity conditions, recovery of housing market, and increasing consumer confidence will direct the U.S. economy to an upward trajectory. We forecast the U.S. economy to expand by 2.5% YoY for 2015F and 2.9% YoY in 2016F

- Most Eurozone countries will continue to face fiscal burden from illegal immigrants, structural adjustment, and banking sector weakness. Higher volatility in the region's capital markets and local economies can be expected after the U.S. rate hike, but ECB is likely to continue or expand the QE program to counteract negative external impacts. We expect Eurozone's GDP to grow by 1.4% YoY in 2015F and 1.7% YoY in 2016F

- In Japan, we believe the BOJ will step up its asset purchase program if situation continues to deteriorate. Structural reform will continue to be a main emphasis of the Abe administration. More focus will be placed on boosting consumption and increasing inflation. We expect GDP growth to be 0.5% YoY for 2015F and 1.2% YoY for 2016F

- Falling oil and commodity prices, slowdown in China, geopolitical tensions, and the rising U.S. interest rates have been exerting pressure on the emerging regions. Nonetheless, India will be the bright spot in the emerging market with GDP growth exceeding 7% in 2015F and 2016F

- With more emphasis toward quality and efficiency, along with policy changes in areas including investment, international trade, land rights, and pricing mechanisms，China will experience a structural slowdown. We expect the country's economic growth to slow to 6.8% in 2016F. In our view, an economic hard landing is highly unlikely

- We expect Hong Kong's property prices to decline by 5% to 10% in 2016F. The launch of Shenzhen-Hong Kong Stock Connect will be a major driver supporting the stock market in 2016. Overall, we estimate Hong Kong's economy to grow by 2.3% and 2.1% for 2015F and 2016F. End-2016F targets for HSI and HSCEI are 23,875 and 12,271

Investment Highlights

Sector	Rating	Stock Picks
China Banks	Overweight	ICBC (1398 HK);CCB (939 HK)
China Brokerage	Overweight	Huatai Securities (6886 HK)
China Insurance	Overweight	China Life (2628 HK); China Reinsurance (1508 HK); Ping An (2318 HK); PICC P&C (2328 HK); Tencent (700 HK)
China Nuclear Energy	Overweight	CGN Power (1816 HK)
China Property	Overweight	Evergrande (3333 HK); Logan (3380 HK);Wanda (3699 HK);
China Solid Waste Sector	Overweight	China Everbright Int'l (257HK)
China Wastewater	Overweight	China Enterprises Water (371 HK)
China Wind Power	Overweight	China Longyuan Power (916 HK); Huaneng Renewables (958 HK)

Source(s):ABCI Securities

Global Economy: A stagnant secular growth

- In 2016, economic recovery across the world will be uneven, with Europe and Japan being the notable laggards while the U.S. will enjoy a stable recovery
- Growth in the emerging market is expected to ease further in 2016. Capital outflow, geopolitical risks, low commodity prices are weighing on economic growth
- China's priority will be on implementing structural adjustments in the economy to ensure sustainable growth
- China's growth momentum will accelerate steadily with more accommodative stimulus policies to support economic rebalancing in consumption and investment

The global economy was still struggling in 2015 as external vulnerabilities and domestic challenges stalled the recovery pace of many countries. Developed economies outperformed as the U.S. continued to experience solid economic expansion and the Eurozone have turned the corner. The developing nations have been in poor shape. China and other emerging markets are affected by internal economic rebalancing and external factors such as the impending U.S. rate hike, low commodities prices, stagnant external demand, and geopolitical events.

In 2016, economic recovery across the world will be uneven. In the U.S., a stronger USD may curb substantial rebound in economic activities but help offset the inflationary pressure. Normalization of monetary policy through rate hike will continue to rev up economic momentum. Abundant liquidity, recovery of housing market, and increasing consumer confidence will direct the U.S. economy to an upward trajectory. In Europe, most Eurozone countries will continue to face fiscal burden from illegal immigrants, structural adjustment, and banking sector weakness will remain as the significant drags on economic activities over the next few years. In Japan, the structure reform of PM Shinzo Abe's reform package will continue to disappoint, but the extension of QE program will further weaken JPY, stimulating exports and enhancing corporate profitability. Hence, we believe growth prospect of Japan will improve mildly. Growth in the emerging market will ease further in 2016 due to capital outflow, low commodity prices, and low growth worldwide. Fiscal imbalance in Brazil, geopolitical risks in Russia, and reform barriers in India involving conflicting interests of business and bureaucracy will continue to persist. We believe structural reform will still be crucial to the emerging market, although the governments may prioritize growth-prompting policies for more immediate gain. A slow-motion growth, accompanied by mild inflation expectations, will lead to more interventions from the central banks and extension of accommodative policies. The scale and scope of these policies and their effectiveness will affect the market.

China has entered a "new normal" of slower growth. The country's priority will be on implementing structural adjustments on the economy to ensure sustainable growth. It will continue its shift toward a more liberalized economy where the market will play a decisive role in resource distribution. The 13th Five-Year Plan (FYP) will focus on new themes including the New Silk Road Vision, China Manufacturing 2025 plan, Internet-Plus strategy, environmental protection, SOE reforms, income distribution reform, and population policy reform.

We expect China's economic momentum to accelerate steadily. The country will enact more accommodative stimulus to support economic rebalancing in consumption and investment. After the GDP growth bottomed out in 3Q15, a mild rebound is expected for 4Q15 and a full-year growth of 7% is likely to be achieved. Undergoing the process of economic rebalancing, China's GDP will edge down to 6.8% YoY. Driven by consumption and investment, Hong Kong's economic growth in 2015F and 2016F will remain stable in the range of 2- 2.5%.

Exhibit 1: Global economic growth forecasts (YoY %)

YoY%	2011	2012	2013	2014	2015F	2016F	2017F
U.S.	1.6	2.2	1.5	2.4	2.5	2.9	3.1
Eurozone	1.6	(0.8)	(0.3)	0.9	1.4	1.7	1.7
Germany	3.7	0.6	0.4	1.6	1.4	1.6	1.6
France	2.1	0.2	0.7	0.2	1.3	1.5	1.7
Italy	0.6	(2.8)	(1.7)	(0.4)	0.5	1.2	1.1
Spain	(0.6)	(2.1)	(1.2)	1.4	2.8	2.5	2.1
Netherlands	1.7	(1.1)	(0.5)	1.0	1.8	2.0	2.2
Greece	(8.9)	(6.6)	(3.9)	0.8	(2.6)	(1.7)	1.2
Portugal	(1.8)	(4.0)	(1.6)	0.9	1.4	1.6	1.4
Ireland	2.6	0.2	1.4	5.2	4.7	4.2	4.0
UK	1.6	0.7	1.7	3.0	2.6	2.3	2.2
Japan	(0.5)	1.7	1.6	(0.1)	0.5	1.2	1.5
Mainland China	9.5	7.7	7.7	7.3	7.0	6.8	6.6
Hong Kong SAR	4.8	1.7	3.1	2.5	2.3	2.1	2.1
Singapore	6.2	3.4	4.4	2.9	2.2	2.2	2.0
South Korea	3.7	2.3	2.9	3.3	2.7	3.3	3.5
Russia	4.3	3.4	1.3	0.6	(4.0)	(1.2)	1.5
India	6.6	5.1	6.9	7.3	7.4	7.6	7.8
Brazil	3.9	1.8	2.7	0.1	(3.2)	(0.8)	1.8
South Africa	3.2	2.2	2.2	1.5	1.3	1.3	1.8

Source(s): IMF, ABCI Securities estimates

U.S.: Steady growth ahead

- The U.S. economy delivers mixed signals in 2015; improvements are seen in GDP and private consumption, but capital investment and industrial production show declining growth
- Job market recovery continues to be on track in general. Housing market will strengthen, but consumption will show short-term decline in growth and the industrial sector will be pressured
- Fed's rate hike is highly likely in Dec; we expect the Fed's rate hike path would be gradual and flexible, but turbulence in financial market and in the developing markets is inevitable
- We project that the U.S. economy would grow by 2.9% YoY for 2016F and 3.1% YoY in 2017F

A mixed bag of news in 2015

In 2015, the U.S. economy has been improving. Annualized GDP growth in 2Q15 and 3Q15 was 3.9% QoQ and 2.1% QoQ. Domestic demand remains resilient. Personal consumption is growing steadily and expanded by 3.0% QoQ in 3Q15. Property prices and sales continue to trend up. However, low oil price and anemic global growth have been taking tolls on the economy. Private investment was the worst-performing sector, falling by 0.3% QoQ in 3Q15 as capital investment was stalled by the energy sector. Industrial production growth declined to a new low since 2010. A stronger USD is hurting exports, as reflected by the ISM manufacturing PMI of 48.6% in Nov 2015. We expect the U.S. GDP would grow by 2.5% YoY in 2015F.

A healthy job market to support the Fed's tightening stance

The U.S. job market recovery continues in 2015. Unemployment rate has been trending down to 5% in Nov, the lowest since Apr 2008. Non-farm payroll and job openings both increased substantially since their lows in 2009. The part-time jobs to total employment ratio, as well as the part-time jobs for economic reasons to total part-time jobs ratio, has been declining. The Fed has been citing the continued improvement in the job market to support its potential rate hike decision in Dec. However, more voluntary exits from the job market have been observed, as reflected by the continued decline in labor force participation rate and the increasing proportion of part-time jobs for non-economic reasons.

Housing market strengthens

The monthly number of new home and existing home sales, along with the housing prices, has been increasing. More importantly, home equity reached US$ 12.1tr in 2Q15, similar to its peak in 2007. However, the housing market rebound is not contributing as much to the economy as many would have believed. First of all, housing price has climbed back to the pre-crisis peaks, which helps homeowners reclaim some of their losses. In addition, the willingness for homeownership is low, as reflected by the rising gap between multifamily home-building permits and single family home-building permits against the increasing rental rates, as well as the declining homeownership ratio against low mortgage interest rate. Moreover, situation in the mortgage financing market has changed since the 2008 crisis. We believe he U.S. housing market will continue on its path of mild recovery as long as the easy lending environment and low mortgage rate can be maintained

Low consumption impetus in the near term

Private consumption has been the main engine of U.S.'s GDP growth in the first three quarters. However, the declining retail sales growth, the inventory drag on GDP growth, disappointing performance of retailers in 3Q15, and the grim outlook for 2015's holiday shopping season by retailers suggest a slower domestic demand growth. Tepid increase in personal income and uncertain economic outlook have curbed domestic consumption, which will experience a slower growth in 4Q15 and regain strength in 2016.

Deteriorating industrial sector is a cause for concern

Industrial production growth fell to 0.34% YoY in Oct 2015, the lowest since 2010, and the ISM manufacturing PMI dropped to 48.6% in Nov. In addition, the country's total capacity utilization has also been declining since late 2014. Aside from the stronger USD and the weak global demand, capacity consolidation triggered by technological innovation also contributes to the recent decline in industrial activities. The U.S. economy will face greater challenges ahead and the Fed will show extreme caution in raising rates.

Post rate hike implications

The rate hike of 25bps in Dec is a highly probable event, and we expect interest rates to increase by 100bps in 2016F. The Fed is compelled to initiate the rate hike cycle as the real economy will suffer if monetary policy remains excessively loose. We can expect a certain degree of market turbulence around the world and the developing countries will be the first to suffer.

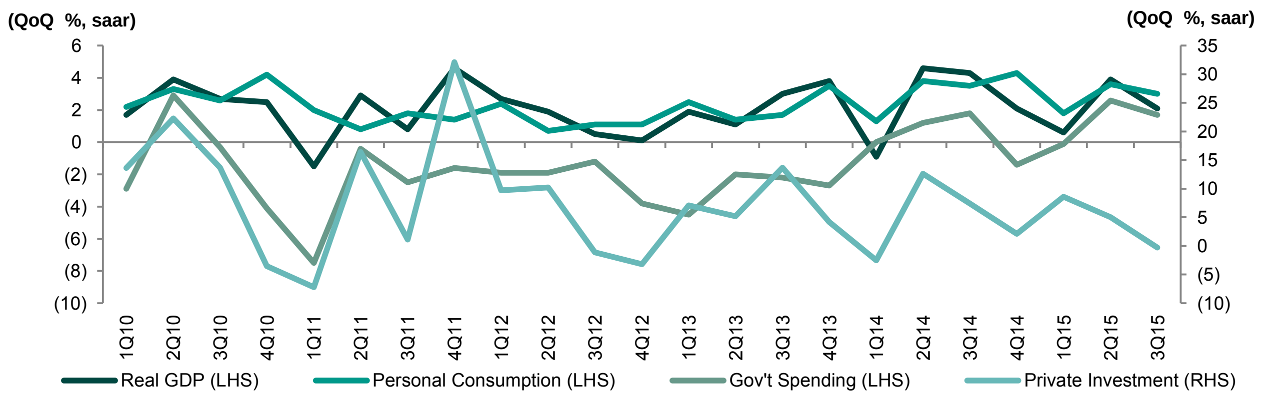
The potential rate hike will expose the U.S. financial market to greater risks. The low interest rate environment has encouraged companies to increase leverage to expand business or conduct capital market activities such as corporate share buybacks in 2015. As of Sep 30, 2015, the proportion of companies in the Russell 3000 Index with a leverage level higher than 100% was 33.13%, compared to 28.16% as of end-Dec, 2013. The increase in corporate risk-taking activities is also reflected in the decoupling of liquidity spread and the default spread since 2014, which we believe is caused by the deteriorating credit quality of energy companies and the increasing leverage of the U.S. companies. If business condition worsens, especially in the energy and raw material sectors, the rate hike may increase the cost of financing, raising the default risk in capital market.

Pressured by the declining oil price, the overall CPI has been hovering at around 0% YoY since the beginning of 2015, while the core CPI (ex-food & energy) increased from 1.6% YoY in Dec 2014 to 1.9% YoY in Oct 2015. Yet, the recent divergence between core PCE and core CPI indicates uncertainties in the labor market; the decreasing impact of low oil price and a strong USD may exert upward pressure on prices. Therefore, we believe the Fed's rate hike will be gradual and flexible.

Outlook of the U.S. economy

Despite the potential weaknesses in the current economy, we believe the U.S. will continue to enjoy a stable growth supported by stronger private consumption and trade surplus. The housing market will continue to improve, resulting in positive spillover to other sectors. The rate hike may depress financial market initially but a rebound will follow if the Fed is able to adhere to the path of gradual monetary tightening. The U.S. economy will continue with its current course of steady growth in 2016F and 2017F and expand by 2.9% YoY and 3.1% YoY.

Exhibit 1: U.S.'s GDP growth



Source(s): Bloomberg, ABCI Securities

Exhibit 2: DJIA Index and S&P 500 Index in 2015

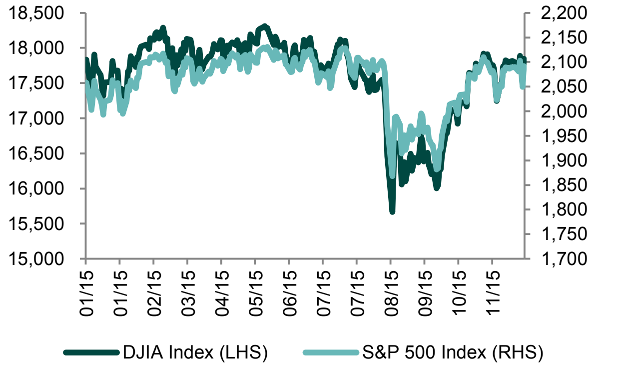
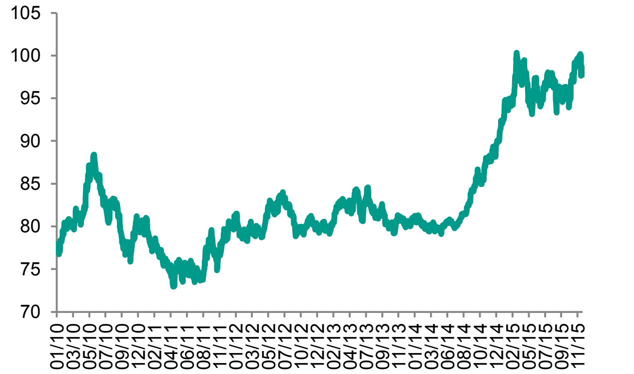
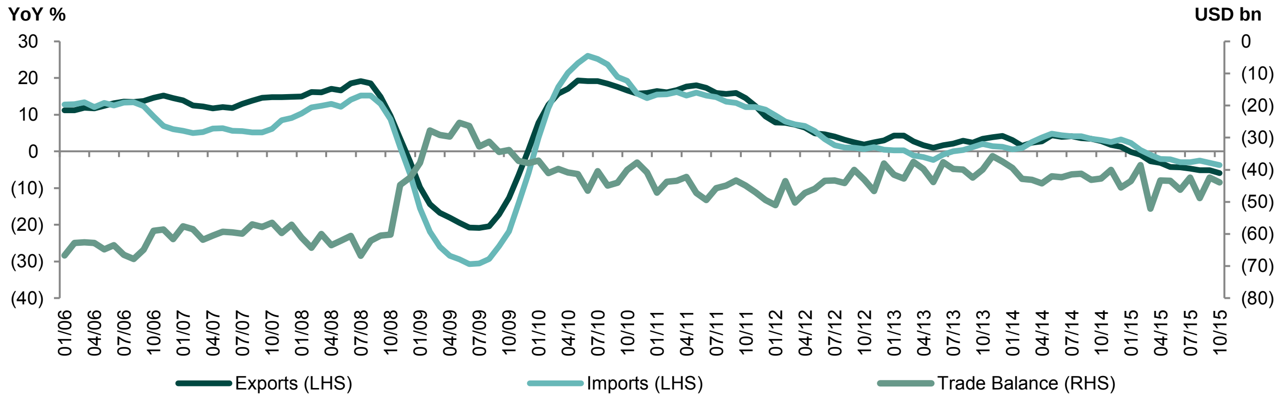


Exhibit 3: USD continues to strengthen in 2015



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: Unemployment and labor force participation rate

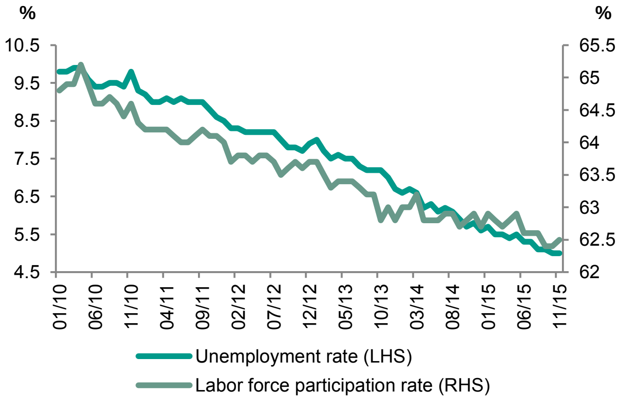
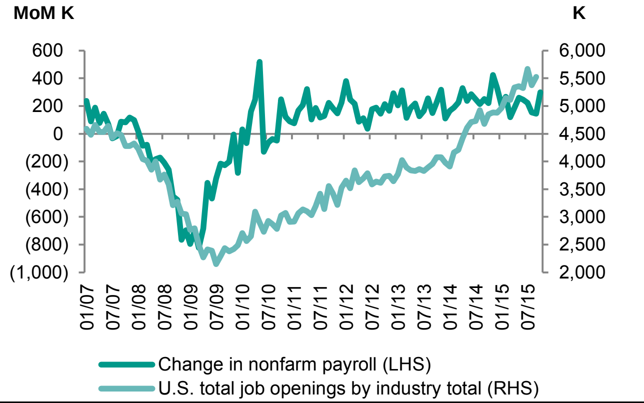


Exhibit 6: Job openings and changes in non-farm payroll in the U.S.



Source(s): Bloomberg, ABCI Securities

Exhibit 7: Rising percentage of part-time workers for non-economic reasons

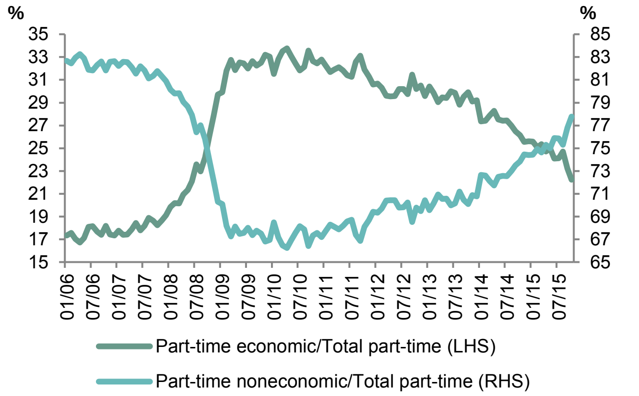
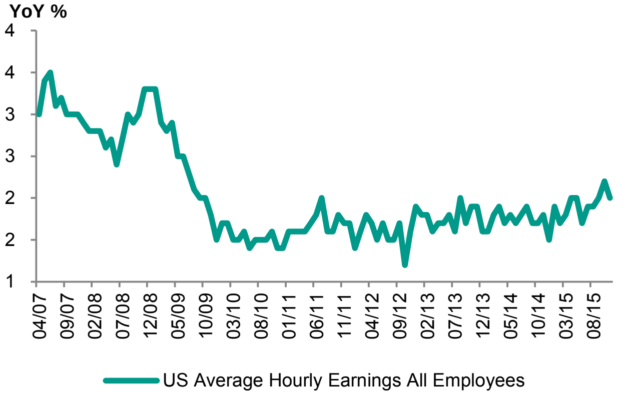


Exhibit 8: Low growth of hourly wages in the U.S.



Source(s): Bloomberg, ABCI Securities

Exhibit 9: U.S.'s PMI

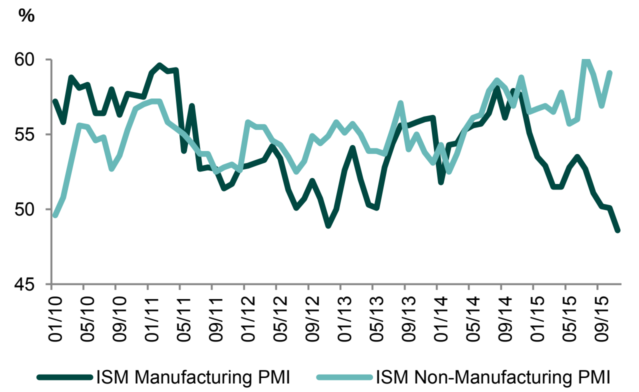
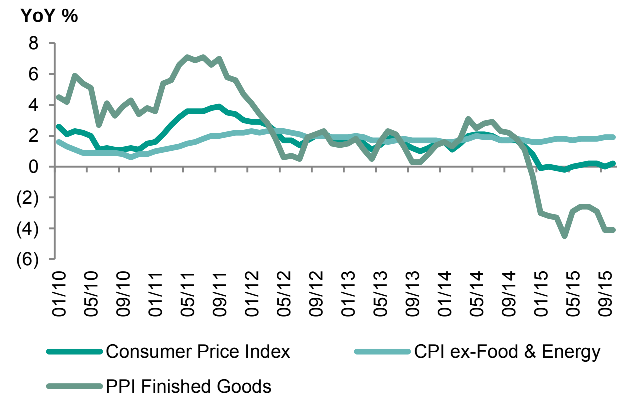


Exhibit 10: U.S.'s inflation rates – CPI & PPI



Source(s): Bloomberg, ABCI Securities

Exhibit 11: Divergence between core PCE index and core CPI

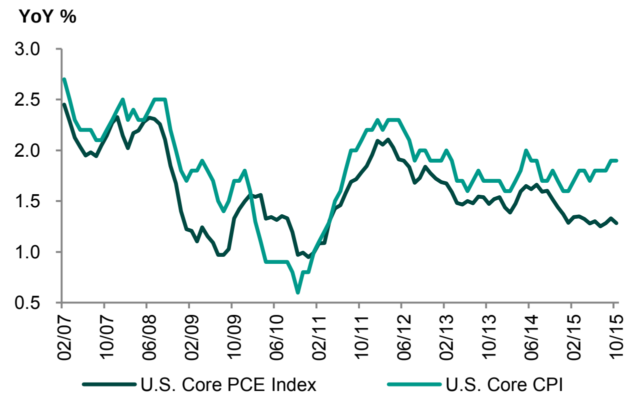
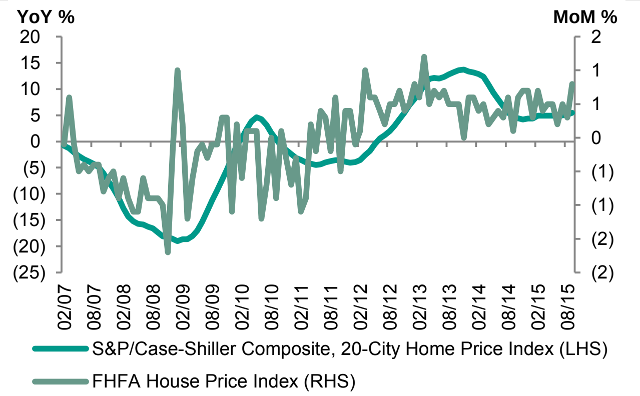


Exhibit 12: U.S's housing prices have been increasing



Source(s): Bloomberg, ABCI Securities

Exhibit 13: Divergence between multifamily housing and single-family home building permits in the U.S.

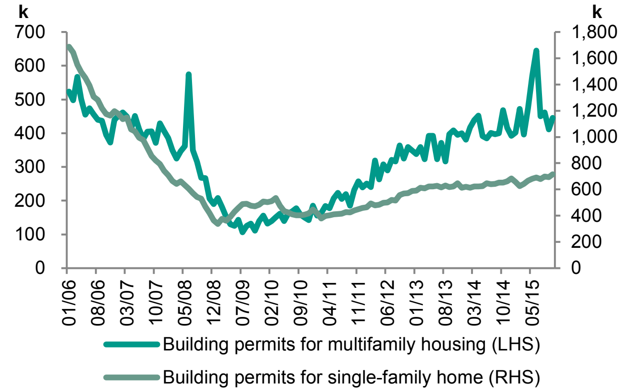
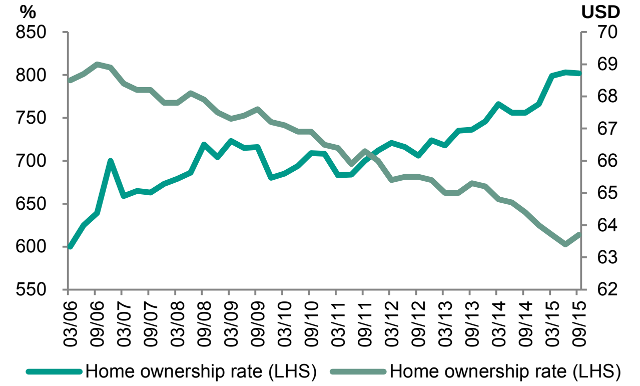


Exhibit 14: Americans are more inclined to rent



Source(s): Bloomberg, ABCI Securities

Exhibit 15: U.S.'s industrial production

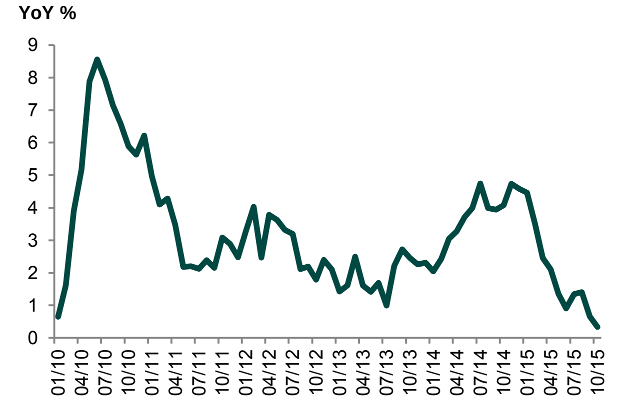
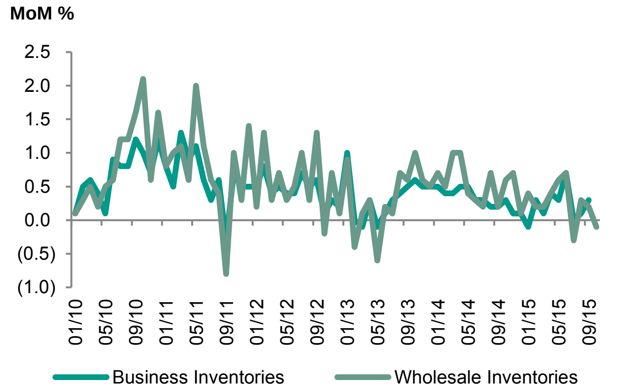


Exhibit 16: U.S.'s factory orders and durable goods orders



Source(s): Bloomberg, ABCI Securities

Exhibit 17: U.S.'s capacity utilization

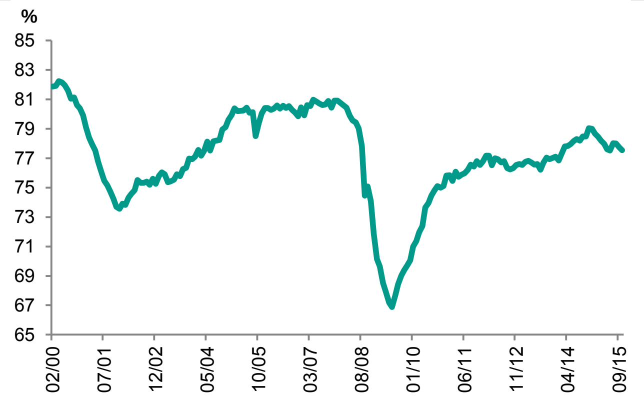
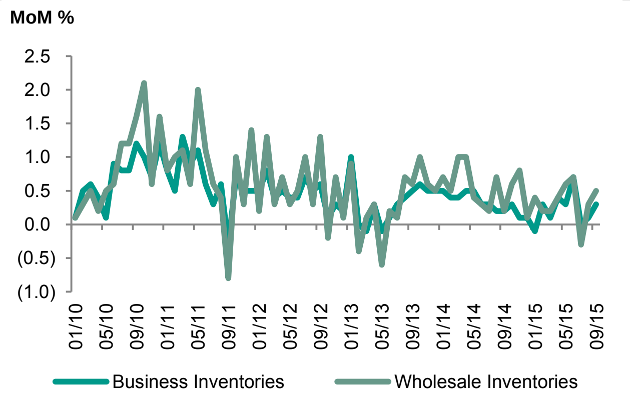


Exhibit 18: U.S.'s inventories change



Source(s): Bloomberg, ABCI Securities

Exhibit 19: U.S.'s personal income, expenditure, and consumer confidence

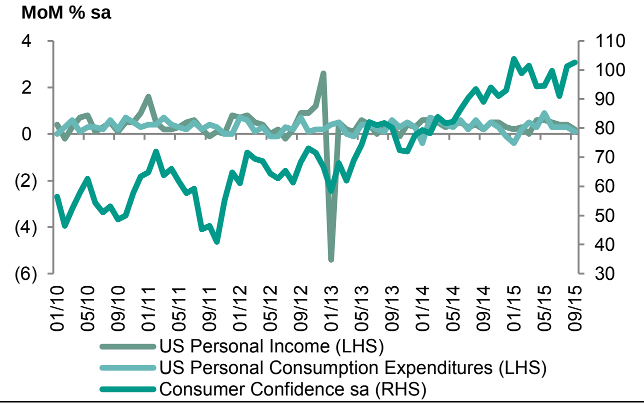
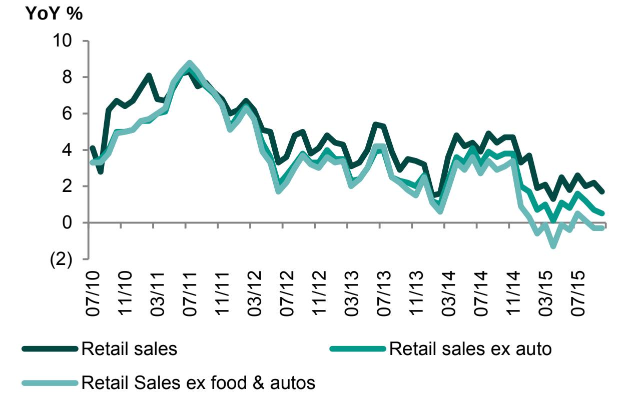
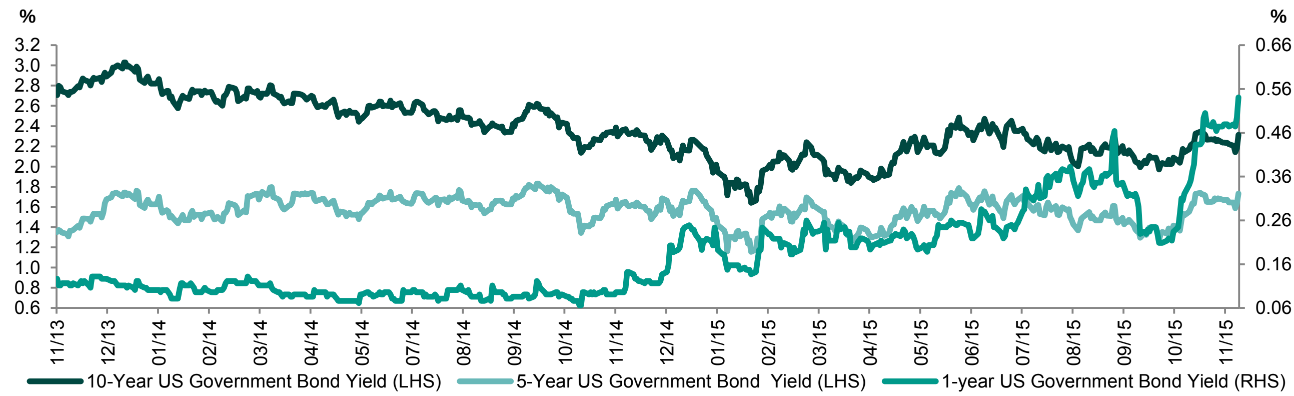


Exhibit 20: U.S.'s retail sales growth



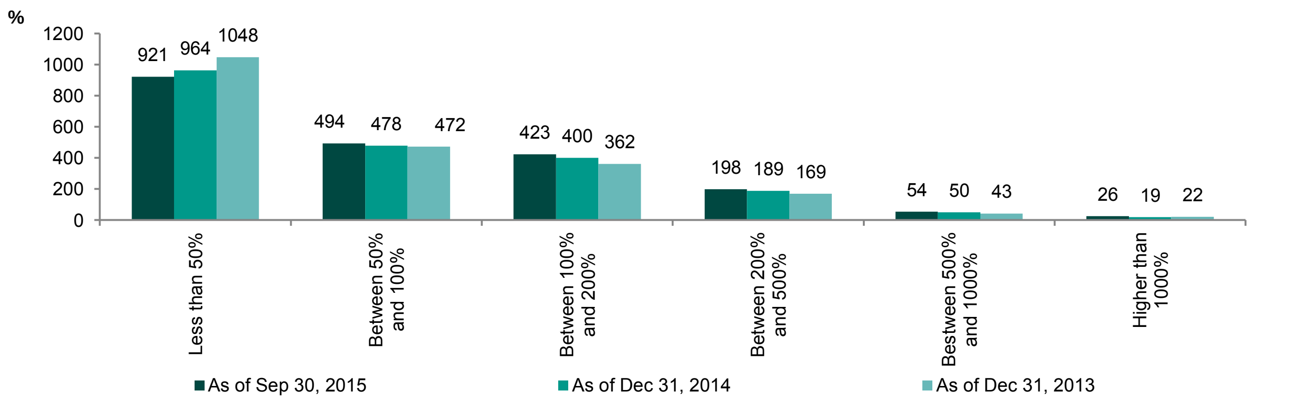
Source(s): Bloomberg, ABCI Securities

Exhibit 21: U.S government bond yields in 2014 & 2015



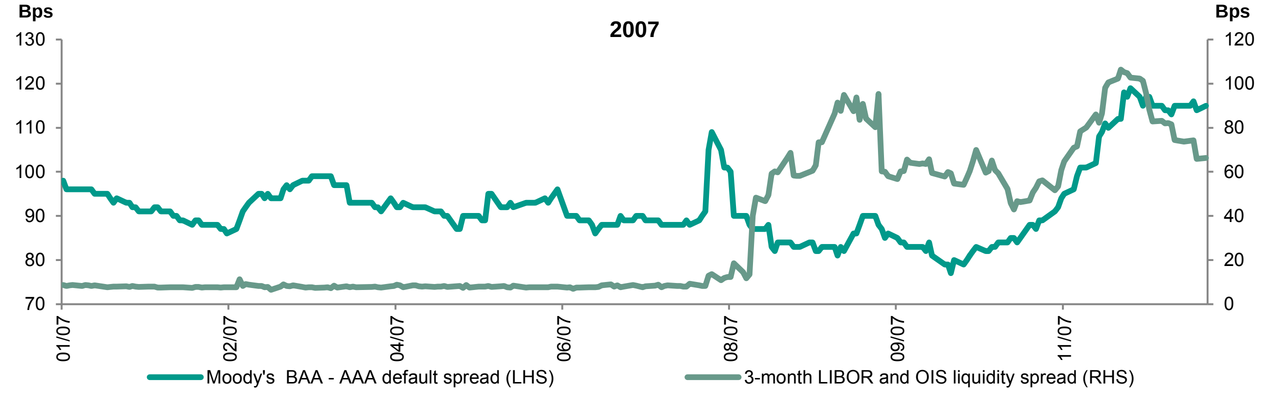
Source(s): Bloomberg, ABCI Securities

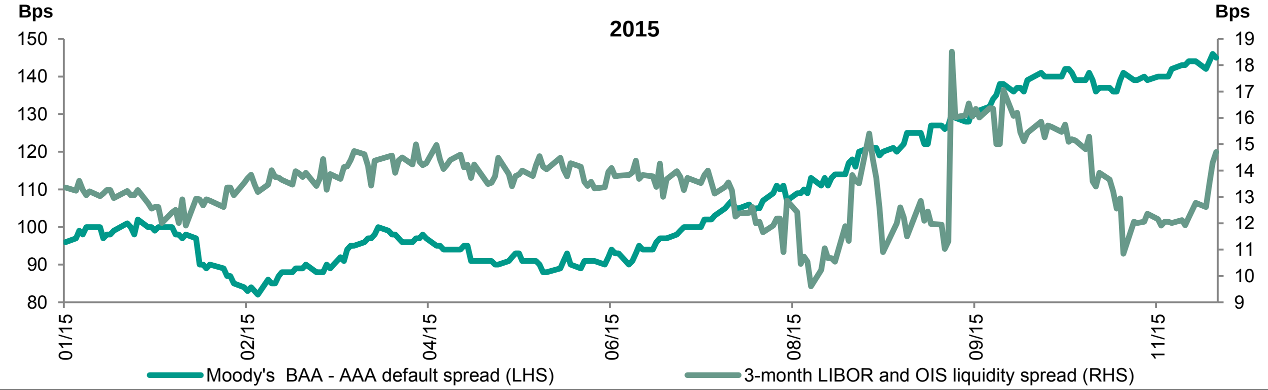
Exhibit 22: Leverage of companies in Russell 3000 Index has been rising



Source(s): Bloomberg, ABCI Securities

Exhibit 23: Liquidity spread and default spread in the U.S.





Source(s): Bloomberg, ABCI Securities

Eurozone: Rocky road ahead

- Decent improvement in Eurozone has been observed in 2015, yet fundamental problems such as low productivity, rigid labor markets, and demographic shifts continue to inflict the region
- Germany has played a crucial role in Eurozone's recovery. Recent slowdown in China and scandal in the auto industry will affect growth in the manufacturing sector and hinder Eurozone's economy
- There are new proposals for regional integration, but resistance from certain members would hamper such efforts
- We expect the Eurozone's GDP to grow by 1.7% YoY in 2016F and 1.7% YoY in 2017F

A long-awaited improvement in 2015

Eurozone's overall economic performance has been improving. The region's GDP growth accelerated from 1.2% YoY in 1Q15 to 1.6% YoY in 3Q15, supported by Germany and the strong rebound in Spain. A breakdown of the currency bloc's GDP shows that fiscal spending, private consumption, capital investment, and net trade have been expanding in decent paces. We expect the GDP of Eurozone, Germany, France, Spain, and Italy to grow by 1.4% YoY, 1.4% YoY, 1.3% YoY, 0.5% YoY and 2.8% YoY in 2015F.

What cures the symptom may not cure the disease

Although the ECB has been conducting the QE program for more than a year, structural issues, such as low productivity, rigid labor markets, and demographic shifts, continued to inflict the region. Such weakness may render the Eurozone more vulnerable to the impact of the Fed's potential rate hike in Dec, and its capital market may encounter higher volatility as a result.

1) **Inflation.** The ECB's QE program has failed to boost inflation. Eurozone's CPI only reached 0.1% YoY in Oct and for its core members, the figure hovered at around 0% YoY. Low commodity prices have been exerting downward pressure on consumer prices. More importantly, we believe the QE program has failed to inject sufficient liquidity into the economic system to stoke inflation since the region's banks have been reluctant to provide credit to businesses over the past few years. The lending situation for non-financial corporations and households only started to improve since mid-2014.

2) **Business and consumer confidence.** Eurozone's consumer confidence has been improving in 2015 despite volatility, reaching -5.9 in Nov 2015. Business confidence has also been going up- the Ifo Business Climate Index for Eurozone shows that businesses are more optimistic on their prospects. However, growth in gross fixed capital formation of Eurozone and Germany has been slow, revealing that the QE program has not been able to motivate businesses to invest.

3) **Unemployment.** Eurozone's unemployment rate remained high at 10.7% in Oct 2015. Unemployment rates for people under the age of 25 in Spain, Italy, and Eurozone were 22.3%, 47.7%, and 39.8%, respectively, in Sep 2015. High joblessness usually implies high social welfare costs, increased risk of social unrest and capacity underutilization.

A not-so-German problem

Germany plays a crucial role in Eurozone's recovery- its GDP contributed to more than 30% of Eurozone's GDP in 3Q15. It is the only core member that achieved a fiscal surplus in 2014 and manages to maintain an unemployment rate below 7% for more than 3 years.

However, Germany's export-dependent economy may slow on declining exports to China, Germany's fourth largest export trade partner in 2014. In Oct, China's import from Germany declined by 26% YoY, dragging down Germany's export growth to 3% YoY. We expect the dwindling trend to continue as the structural adjustment in China will reduce its demand for industrial goods. In addition, the Volkswagen emission scandal and its potential impacts on the auto industry (such as penalties and layoffs) may hamper performance of the manufacturing sector, as suggested by the 0.6% and 1.5% YoY decline in manufacturing orders in Sep and Oct. If Germany's economy continues to deteriorate, the outcome will be negative on Eurozone's overall prospect due to its outsized influence in the region.

Moving further away from a closer union

Recently, Jean-Claude Juncker, the president of the EU Commission, and four other top leaders in the Eurozone proposed to construct a stronger union through economic and financial integration after the unsuccessful attempt to build the European Banking Union. However, the plan has faced strong oppositions from Germany. Central to Germany's argument are the risks involved in the deposit insurance scheme and mutual risk-sharing by bond investors. In terms of financial integration, we believe the scheme should only be initiated after the health of the Eurozone banks improve. Currently, these banks are still weakly capitalized. In addition, fundamental improvement in the fiscal conditions among the weaker member states would become necessary, or else the proposal would only serve as a wealth transfer program that delays the progress of structural reform. After all, Germany has been the only core member capable of bringing down the debt-to-GDP ratio in the past three years.

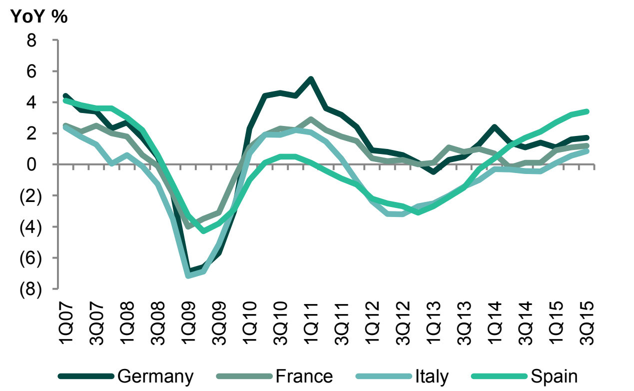
However, even the plan itself is not a foolproof solution to Eurozone's problems. The Eurozone will need to integrate existing mechanisms, such as the European Stability Mechanism, before creating any new governing body. Moreover, if the ECB, EU Commission or any newly-created supervision entity is not granted more power in implementation, proposals for further changes are destined to fail.

Rocky outlook for Eurozone

Although the external environment remains uncertain, Eurozone will continue to improve as domestic consumption picks up and fiscal expansion policies are implemented to enhance the effectiveness of monetary stimulus. Higher volatility in the region's capital markets and local economies can be expected after the U.S. rate hike. ECB's recent actions in cutting the deposit rate and expanding its QE program suggest that that it will maintain its accommodative monetary stance and expand the QE program further to counteract negative external impacts. We expect the Eurozone's GDP to grow by 1.7% YoY in both 2016F and 2017F. Growth in Germany will be resilient, reaching 1.6% YoY in both 2016F and 2017F.

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

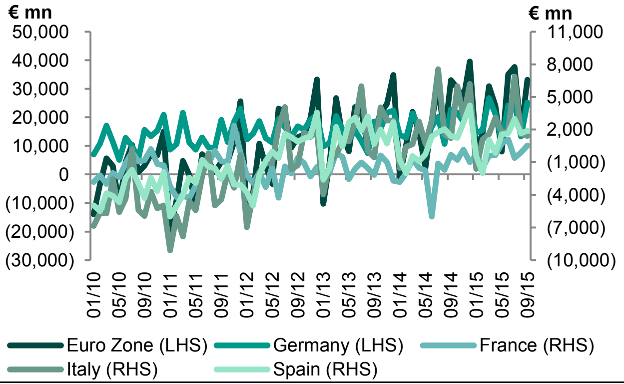
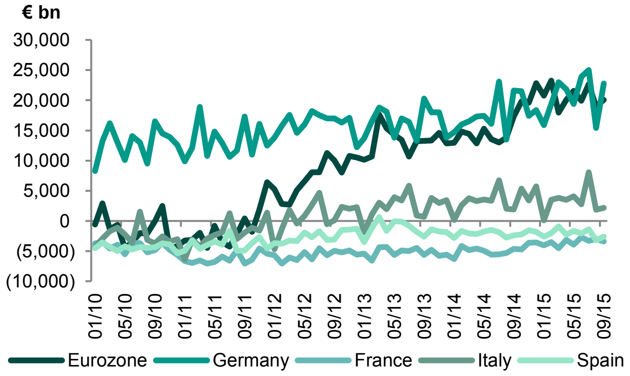


Exhibit 4: Eurozone's trade balance



Source(s): Bloomberg, ABCI Securities

Exhibit 5: Eurozone's PMI

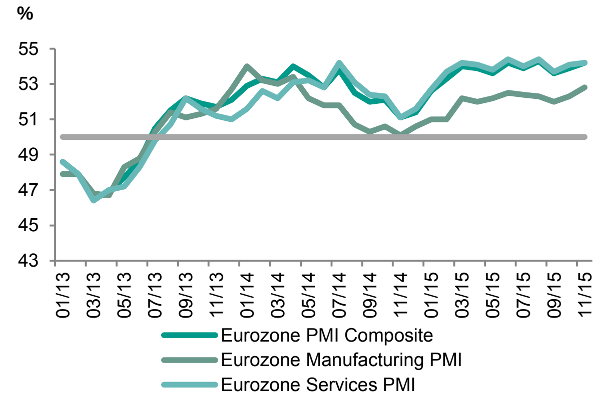
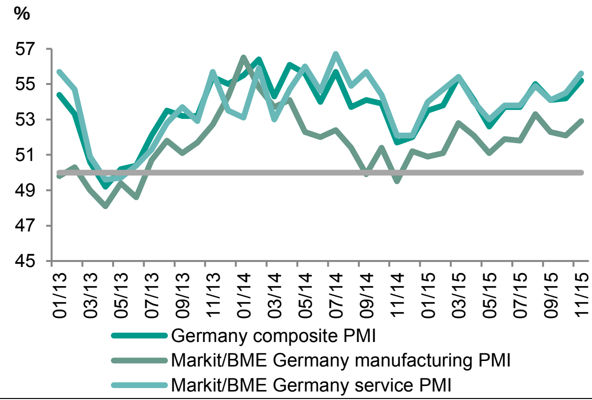


Exhibit 6: Germany's PMI



Source(s): Bloomberg, ABCI Securities

Exhibit 7: CPI of Eurozone and major Eurozone member states

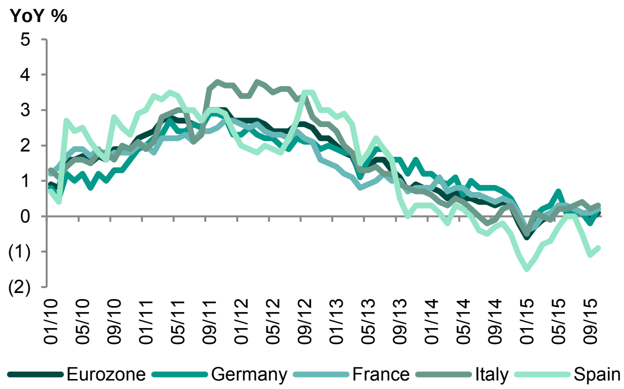
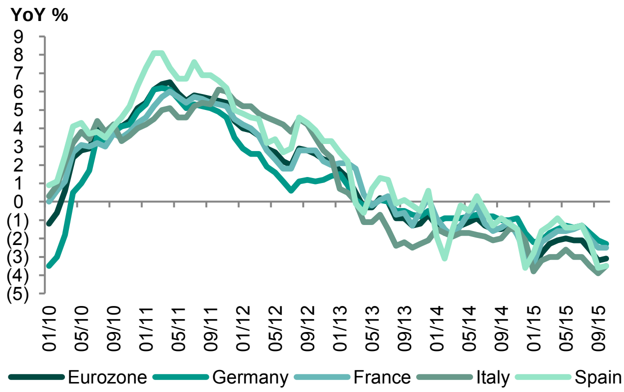


Exhibit 8: PPI of Eurozone and major Eurozone member states



Source(s): Bloomberg, ABCI Securities

Exhibit 9: Eurozone's unemployment rate

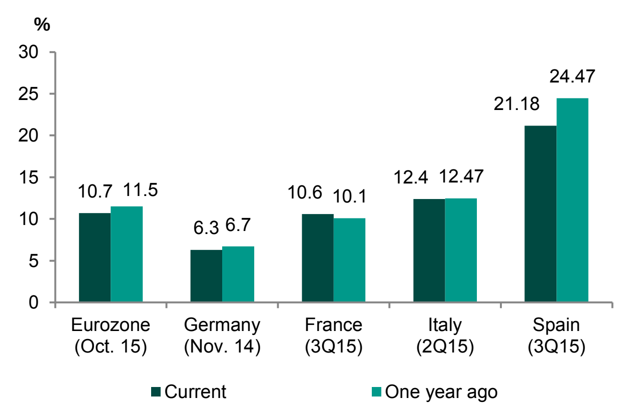
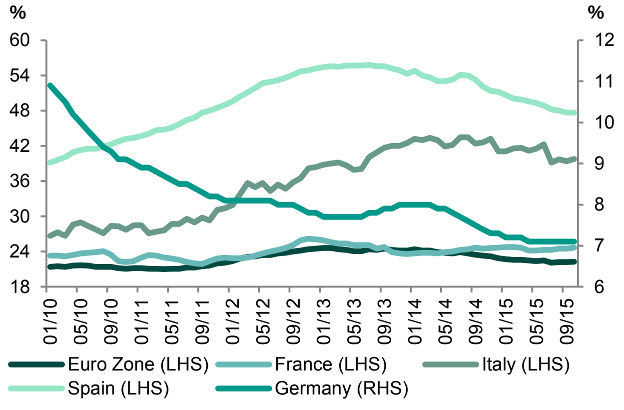


Exhibit 10: Eurozone's unemployment rate – age 25 or under



Source(s): Bloomberg, ABCI Securities

Exhibit 11: Eurozone's retail sales growth

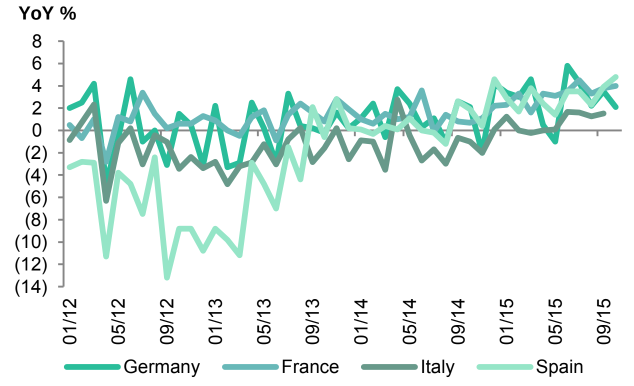
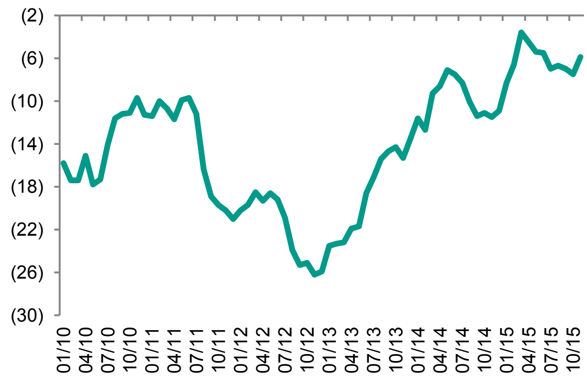


Exhibit 12: Eurozone's consumer confidence



Source(s): Bloomberg, ABCI Securities

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

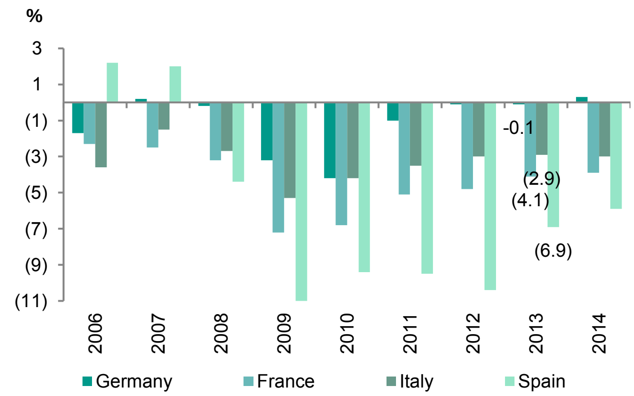
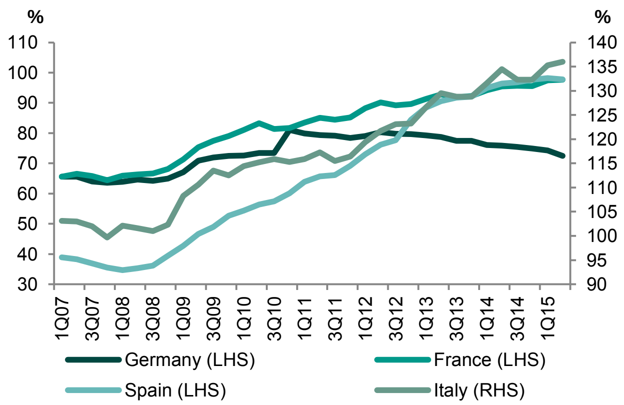


Exhibit 14: Eurozone's government debt/GDP



Source(s): Bloomberg, ABCI Securities

Exhibit 15: Eurozone's 10-year government bond yield

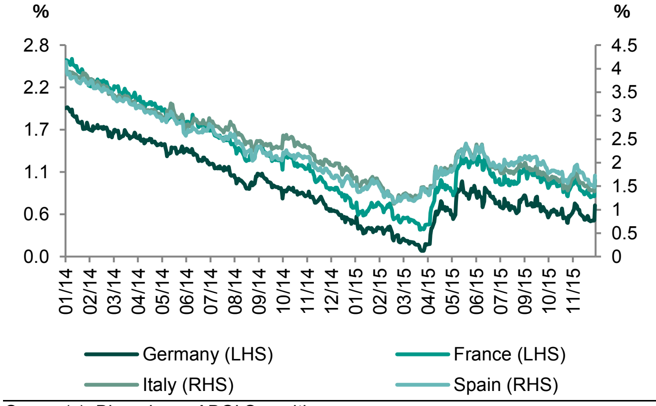
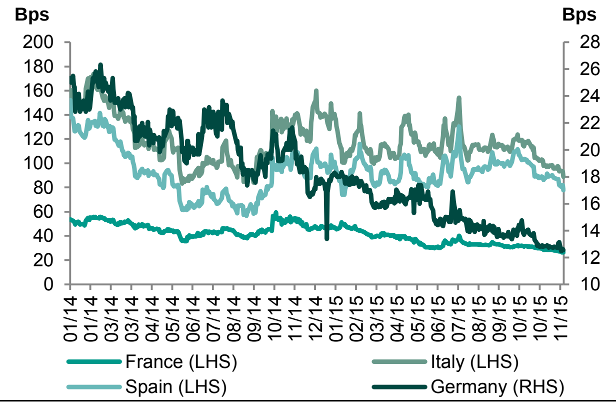


Exhibit 16: Eurozone's 5-year sovereign CDS



Source(s): Bloomberg, ABCI Securities

Exhibit 17: Eurozone's MFI loan to non-financial corporations

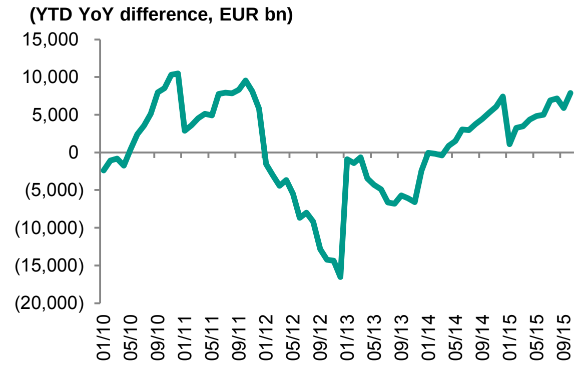
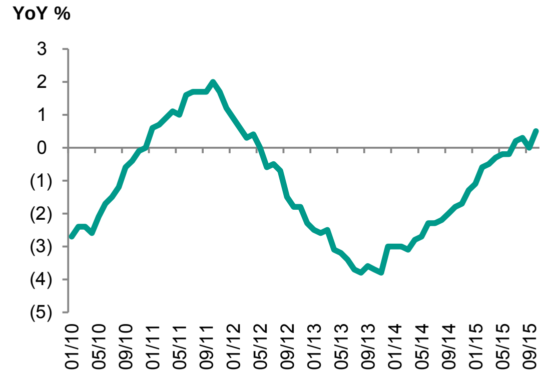


Exhibit 18: Eurozone's MFI loan to non-financial corporations by growth



Source(s): Bloomberg, ABCI Securities

Exhibit 19: Eurozone's MFI loan to households by growth

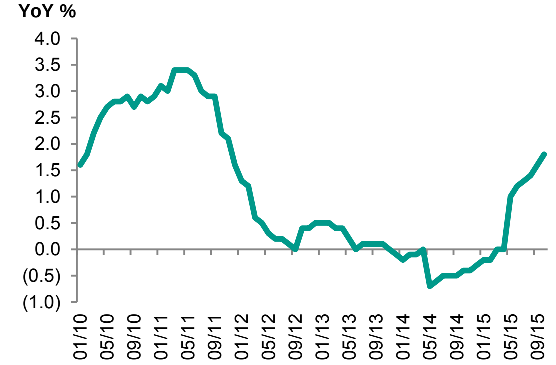
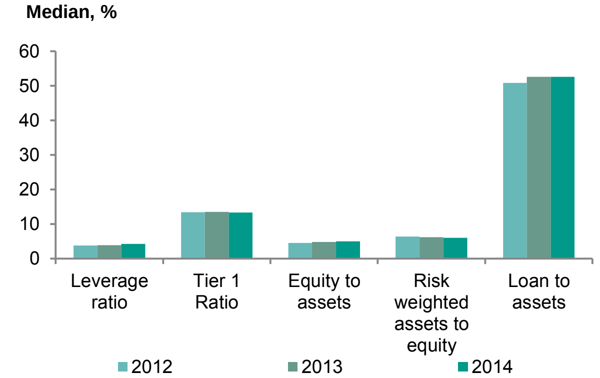


Exhibit 20: Eurozone's banks' key metrics



Source(s): Bloomberg, ABCI Securities

Japan: Limping through low growth and inflation

- Japan's economy has been volatile in 2015. 3Q15 GDP grew by 1% QoQ after a substantial upward revision; the effects of monetary expansion and fiscal stimulus policies started to fade
- Japan's economy faces uncertainties: low wage growth, consumption tax hike, and the slowdown in China all dampened its growth. Nonetheless, improvement has been observed in the job market, inflation trend, and growth in capital investment
- Structural reform will be the main emphasis of the Abe administration. More focus will be placed on boosting consumption and increasing inflation in the near term
- Our forecasts of GDP growth of Japan are 1.2% YoY for 2016F and 1.5% YoY for 2017F

The third arrow is going nowhere

"You are as good as your weakest link" sums up the trouble that Japan is facing at present. The monetary expansion and fiscal stimulus implemented as the first two arrows of Abenomics were unable to revive Japan's economy. The BOJ recently admitted defeat by pushing the deadline of reaching the 2% inflation target by Mar 2017. The third arrow of Abenomics, structural reform, has not made much progress. In addition, the economy has also been affected by external shocks including China's slowdown and the U.S. rate hike. We project Japan's GDP to grow by 0.5% in 2015F.

Dismal economic landscape

Japan's economy has experienced higher volatility in 2015. Its GDP gained 1% QoQ after substantial upward revision in 3Q15. The hype of reflation fantasy and the buoyant stock market have not been able to boost retail sales due to the increase of consumption tax from 5% to 8% in Apr 2014 and the almost stagnant wage growth. China's declining economic growth is also a major challenge to Japan. As of Nov 2015, China's import from Japan recorded a decline of 10.3% YoY, which represented the 13th month of consecutive declines.

On a more positive note, core inflation, which excludes food and energy items, has increased since Apr 2015 and reached 0.7% YoY in Oct. The low unemployment rate and high labor force participation also signal a relatively healthy job market. Moreover, capital investment growth unexpectedly rose to 11.2% YoY in 3Q15 from 5.6% YoY in 2Q15, signaling improvement in business confidence.

Reform progress: More is said than done

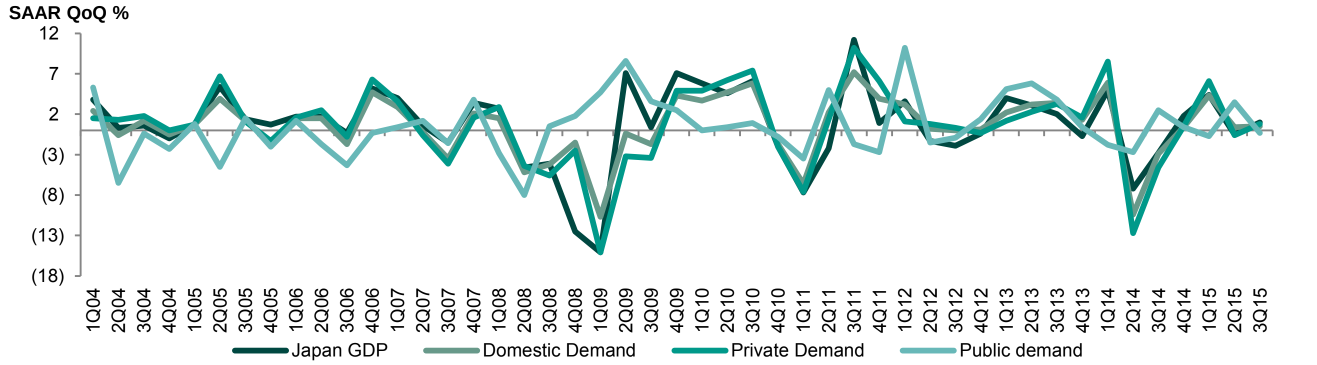
The slow progress in structural reform is a major concern, as the policy momentum of monetary expansion and fiscal stimulus has been receding since their initial launch. The Abe administration has achieved some progress in corporate governance and industry reforms, but major aspects such as the labor market reforms, higher female representation in the corporate world, and relaxation of immigration policies are mostly absent.

We believe the Abe's bold structural reform measures were sidetracked by the deeply entrenched economic and political interests. Therefore, we expect marginal improvements in the reform progress in 2016. Instead, the country's priority will be on boosting inflation and consumption due to the limited time before the next tax rate hike in 2017.

Not going to be an easy year

Challenges in Japan will escalate in 2016. External environment has been deteriorating in recent months. Also, the Fed's rate hike may disrupt the capital market by affecting the fund-flow direction. If conditions continue to worsen, we believe BOJ will step up its asset purchase program to help sustain a low JPY level, which is beneficial to exports and corporate profits. Structural reform will continue to be a main emphasis of the Abe administration. Yet, boosting inflation and reviving the economy will be prioritized in the short term as BOJ is under enormous time pressure to reach its inflation target before the next tax rate hike in Apr 2017. Our forecasts of Japan's GDP growth of Japan are 1.2% YoY for 2016F and 1.5% YoY for 2017F.

Exhibit 1: Japan's GDP growth



Source(s): Bloomberg, ABCI Securities

Exhibit 2: Nikkei 225 Index and TOPIX Index edges up

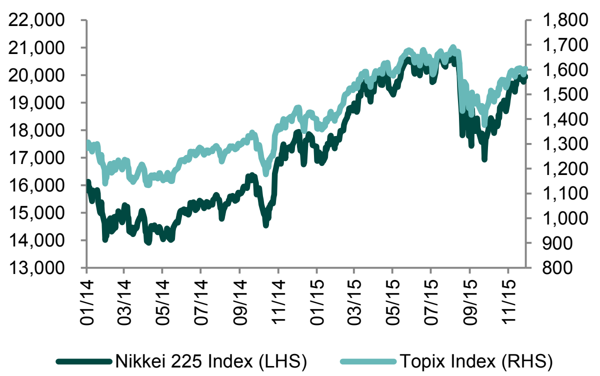
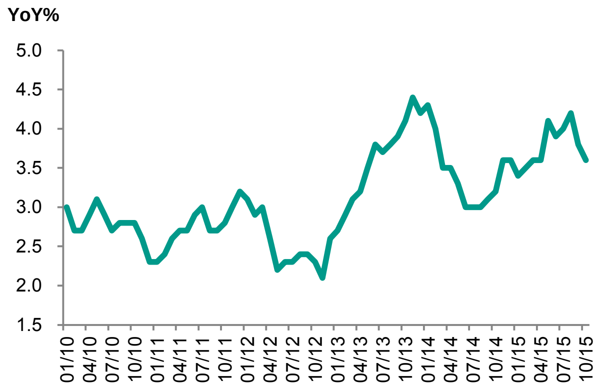


Exhibit 3: M2 growth in Japan



Source(s): Bloomberg, ABCI Securities

Exhibit 4: Japanese Yen depreciates against the USD

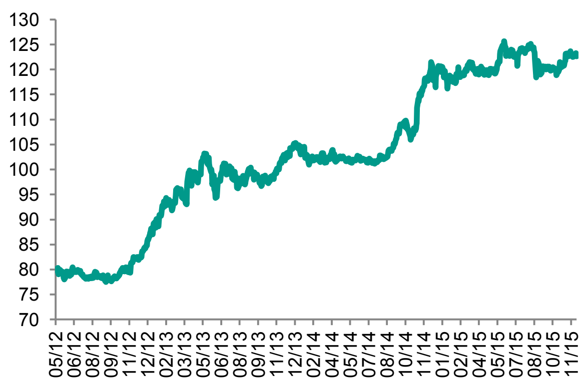
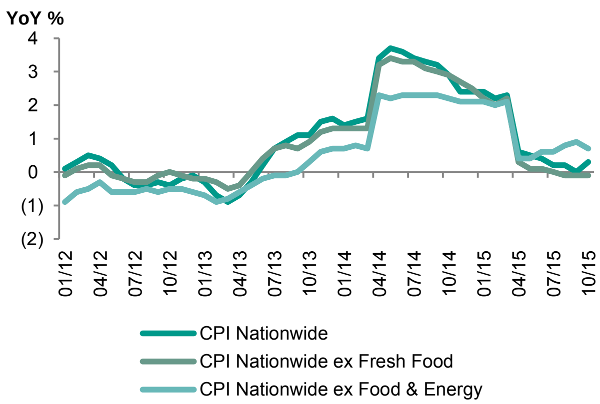


Exhibit 5: Inflation in Japan



Source(s): Bloomberg, ABCI Securities

Exhibit 6: 3MMA exports and imports growth in Japan

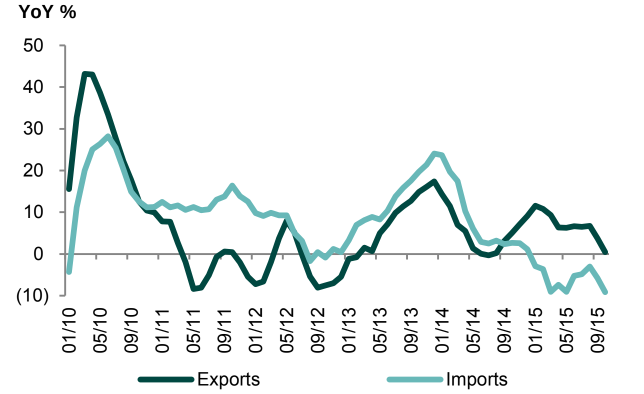
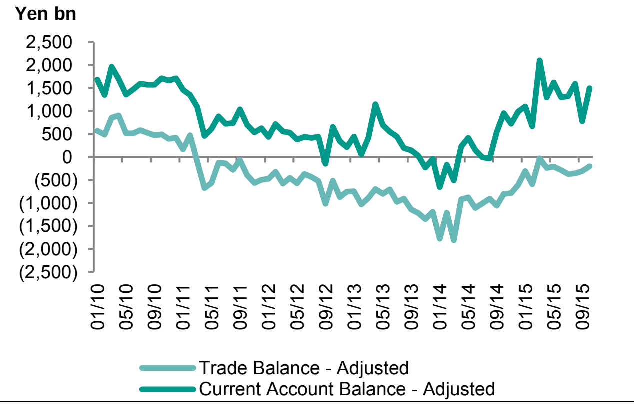


Exhibit 7: Trade balance and current account balance in Japan



Source(s): Bloomberg, ABCI Securities calculation

Exhibit 8: Growth in industrial activities in Japan

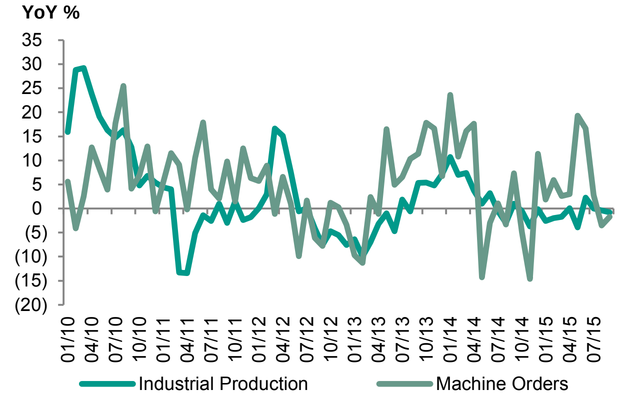
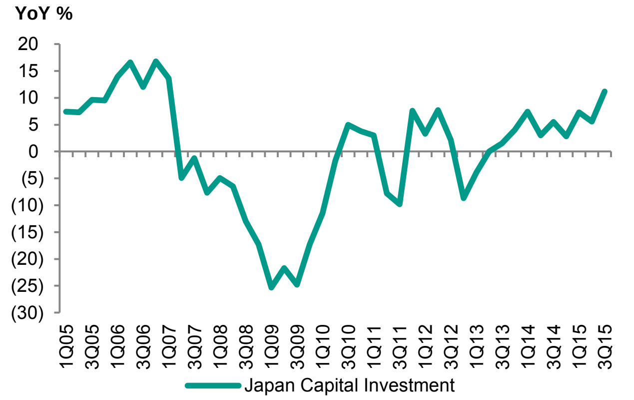
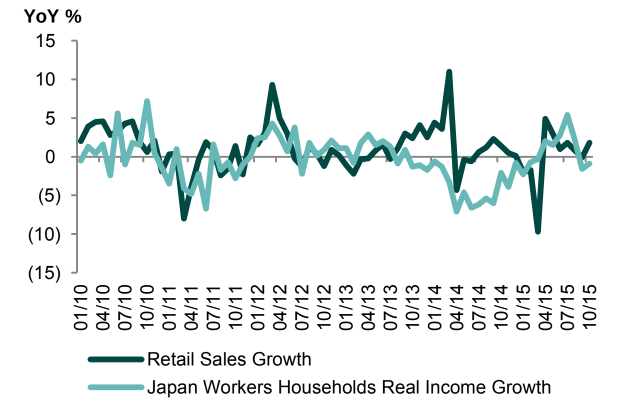


Exhibit 9: Capital investment growth in Japan



Source(s): Bloomberg, ABCI Securities

Exhibit 10: Retail sales and household income growth in Japan



Source(s): Bloomberg, ABCI Securities

Emerging economies: Growth to ease further

- Falling oil and commodity prices, slowdown in China, geopolitical tensions, and the rising U.S. interest rates have been exerting pressure on the emerging regions
- India will be the bright spot in the emerging market. We project the overall GDP growth to be 7.6% and 7.8% YoY for 2016F and 2017F
- We remain cautious on Russia and project its GDP to contract by 1.2% YoY in 2016F and expand by 1.5% YoY in 2017F
- Brazil's economic outlook is clouded by the mounting political and economic risks. We project its GDP to decline by 0.8 % in 2016F and grow by 1.8% YoY in 2017F
- Fraught with structural problems and economic imbalance, ASEAN is highly vulnerable under the current economic situation

One never stands alone

In 2015, growth among the emerging countries has been less than expected with a combination of factors in play: (1) falling oil and commodity prices, which have led to weaker growth in the commodity exporters including Russia, Brazil, Malaysia, Indonesia, etc.; (2) slowdown in China caused by structural transition in the economy resulted in a spillover impact across its trading partners, in particular its commodity suppliers as the country has been a leading buyer; (3) geopolitical tensions in a number of countries, such as Russia, remain high, which entail enormous economic and social costs; (4) the prospect of rising U.S. interest rates, a stronger USD and the relative currency depreciation in many emerging regions have contributed to higher financing costs and funding risks.

These exogenous factors exerted downward pressure on the emerging economies, partly by amplifying the existing structural weaknesses. Looking forward, the emerging economies may face a lower growth, even though the situation may be alleviated by the increased economic activities in the advanced economies. The actual benefit derived from lower oil prices will depend on how much of the reduced cost can be passed through to consumers and if the energy-cost saving would be eradicated by currency depreciation. Also, these economies would need to guard against the continuous capital outflow seen in the recent months as growth prospects and asset prices in the regions have been falling, which could hamper domestic demand and trigger a vicious cycle of economic downturn.

India: A bright spot among the emerging economies

Unlike its emerging peers, India's economy remains sound in 2015. Even though its economic growth decelerated slightly in 3Q15, the overall GDP growth for the quarter still remained at above 7% YoY, supported by Modi's various reform packages to open up sectors, reduce red tape, promote continuous capital inflow and maintain a steady investment for infrastructure projects.

The RBI has recently lowered the repo rate by 50 bps to 6.75% at end-Sep, reflecting the need to boost consumption and investment to offset the slowdown in external demand. However, inflation shows a diverging trend, with the difference between CPI and WPI reaching 8.81% in Oct. Another issue is that the economic reforms proposed by the Modi administration have been progressing rather slowly because of numerous political and bureaucratic hurdles. Going forward, more resistance against reforms can be expected due to the defeat of his Bharatiya Janata Party (BJP) in Bihar.

Nonetheless, India will be the bright spot in the emerging market in 2016. The accommodative stance of the RBI will help boost consumption, investment, and market confidence. Against the backdrop of an uncertain global outlook, the Indian government would need to initiate proactive measures to maintain its current growth pace and persevere with the revitalization in the manufacturing sector. Moreover, it should continue to open up industries and sustain the current investment rate for infrastructure projects. We project its overall GDP growth to be 7.6% YoY and 7.8% YoY for 2016F and in 2017F.

Russia: Hurt by low commodity prices and sanction

Being an exporter of major commodity goods and a close trading partner of China, Russia is not immune to the recent bout of global downturn. The sanctions imposed by the U.S. and E.U. on Russia have limited its access to the international trade and financial markets. As a result, Russia's GDP contracted in the last three quarters (1Q15: -2.2% YoY; 2Q15: -4.6% YoY; 3Q15: -4.1% YoY).

Due to the depressed oil prices, Russia's 10M15 crude oil export value fell by 43% YoY. This downtrend is likely to persist on China's slowdown, new regulations limiting commodity trading by financial institutions, ample oil supply in the U.S., and more importantly, the lack of willingness to reduce oil production by Russia and Saudi Arabia. In addition, the fundamental weakness in Russia's economy has also been exacerbated by the sanctions imposed by the U.S. and E.U. Inflation in Russia has been surging due to the increased cost of imports and weakening RUB. The country's overall CPI has been above 15% YoY since the beginning of this year, much higher than the official target of 4%.

Russia is facing a difficult year ahead. The recession will no doubt force the BOR to be more accommodative, and rate cut is possible in Dec. The country may resort to currency devaluation to boost exports. However, these two measures may backfire with the high inflation and low consumption in the country. Fiscal constraint is also a concern, since revenue from the oil industry is declining while military expenses on Crimea and Syria are increasing. We remain cautious on Russia and project its GDP to contract by 1.2% YoY in 2016F and expand by 1.5% YoY in 2017F.

Brazil: Dragged by fiscal mismanagement and commodity slump

The slowdown of China's economic growth, subsequent decline in commodity prices, and the change of funding situation triggered by the imminent U.S. rate hike resulted in the worst recession for Brazil in 25 years. GDP of Brazil was in a contraction streak for six quarters and declined by 3% YoY in 2Q15 and 4.45% YoY in 3Q15.

Exports of Brazil's commodity goods have been impacted heavily by the declining prices and weakening global demand. Crude oil and iron ore, the two major commodity exports of Brazil, experienced declining growth in volume and value in 2015. High trade exposure to China also put Brazil in a vulnerable position since the Chinese demand for imported goods has been decreasing. The nominal exports of Brazil fell in the last sixteen months (Nov: -11.76% YoY), with exports to China declining by 14.5% YoY in 10M15.

Brazil is also suffering from the ramifications from policies implemented by President Dilma Rousseff a few years back. Brazilian fiscal budget has been deep in the red due to Rousseff's tax cut to encourage industrial development and expansion in public spending. Rigidity of Brazil's budget also poses challenges for the country. Surging inflation rates in recent months is a malicious consequence of the price limits on fuel and electricity. As domestic economy wanes, artificial limits on prices became unsustainable and the accumulated upward price pressure eventually spilled across the economy. Moreover, Brazil's previous pro-consumption policies have sent private household debt soaring, as reflected by the high household debt to disposal income ratio. Meanwhile, the tumbling economy has been driving up unemployment rate since the beginning of 2015. Increases in loan default rate would wreak havoc on the banking industry as well as the economy, destroying the consumption-driven economic model that the Brazilian government has spent years building.

We believe that the mounting challenges that Brazil faces will dull the country's economic outlook. The government is in urgent need to restore a healthy balance sheet, conduct reforms within the government, and rebalance its economic structure. Going into 2016, Brazil's economy outlook is clouded by political uncertainties, including the possible removal of Rousseff from presidency and the ongoing oil industry scandal involving high-level government officials and business executives. Hence, we project its GDP to decline by 0.8 % YoY in 2016F and increase by 1.8% YoY in 2017F.

ASEAN: Lagging behind in 2016

China's import from ASEAN has dived since Mar 2015. Impacts on Indonesia and Malaysia, the two biggest economic entities in the region, are pronounced due to their heavy reliance on exports (such as oil, gas, and palm oil, or manufacturing products) to support growth. Also, structural weakness of the ASEAN countries continued to persist, as demonstrated by slow pace in infrastructure investment in Indonesia, short-term crowd-pleasing policies in Malaysia, and slow economic progress in Thailand caused by the changes in the political regime. As the U.S. rate hike is expected to tighten international funding, it has been increasingly difficult to manage the impacts of capital outflow. Indonesia, Malaysia, Philippines, and Thailand recorded a GDP growth of 4.73% YoY, 4.7% YoY, 6% YoY, and 2.9% YoY for 3Q15, which were much less impressive compared to their previous pace.

As such, ASEAN is highly vulnerable under the current economic situation. We expect the ASEAN countries to continue to engage in currency devaluation to increase competitiveness in the international trade market and combat the lower demand from major trading partners. Supported by low inflation in most countries, monetary policies will be accommodative, and benchmark rate or reserve requirement will continue to fall. Fiscal expansion will be deployed to fight against the slowdown. A possible catalyst for the region's growth will be further agreements to accelerate integration of the ASEAN member states that help promote trade and investments in the region.

Exhibit 1: GDP growth of Brazil, India, and Russia

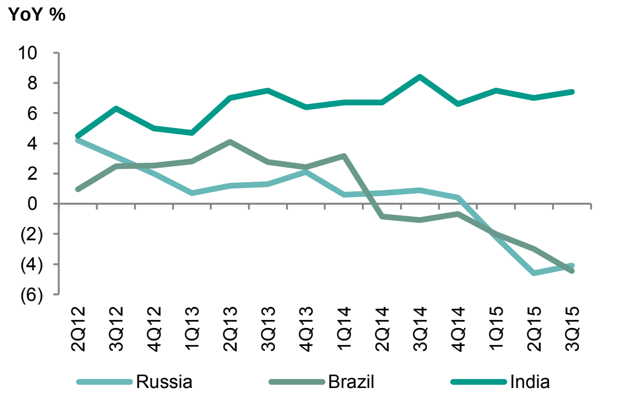
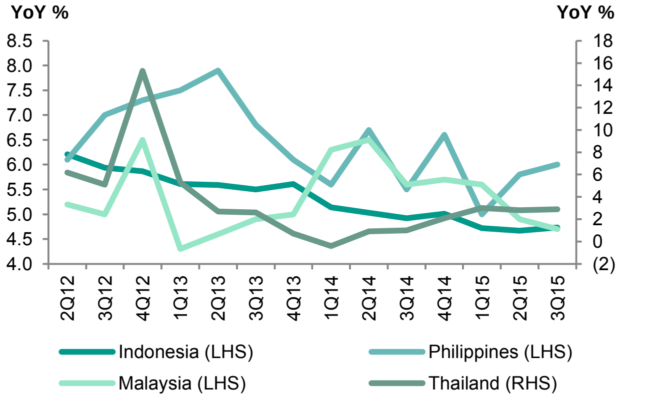


Exhibit 2: GDP growth of major ASEAN countries



Source(s): Bloomberg, ABCI Securities

Exhibit 3: Currency value of Brazil, India, and Russia

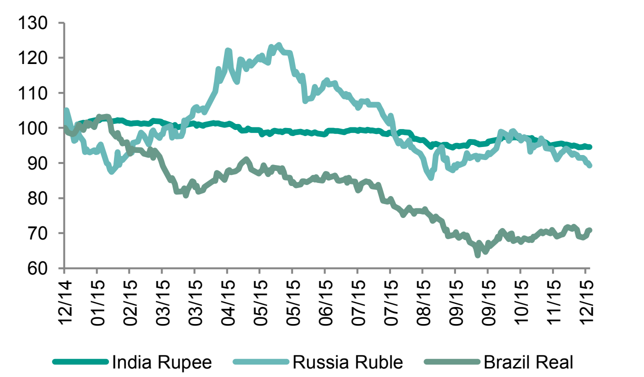
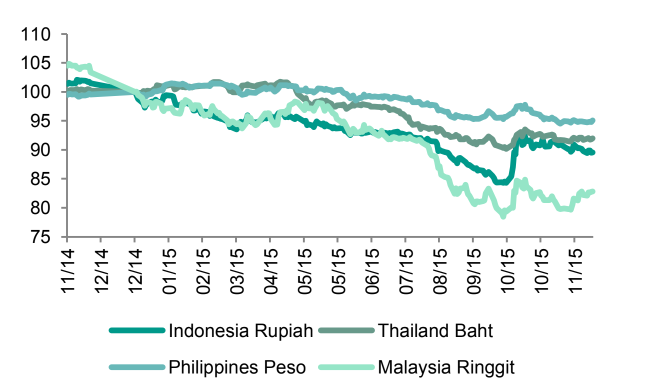


Exhibit 4: Currency value of major ASEAN countries



Note: Baseline = Dec. 31, 2014
Source(s): Bloomberg, ABCI Securities

Exhibit 5: Equity indices of Brazil, India, and Russia

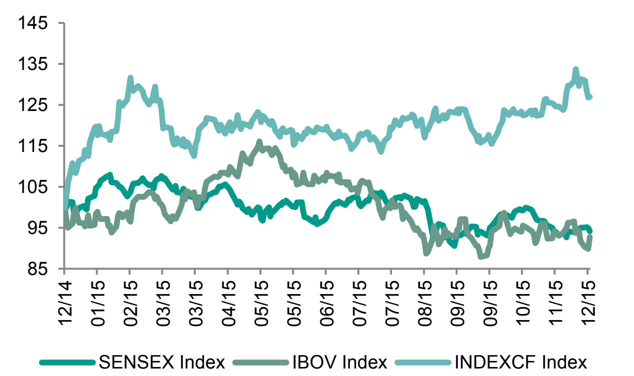
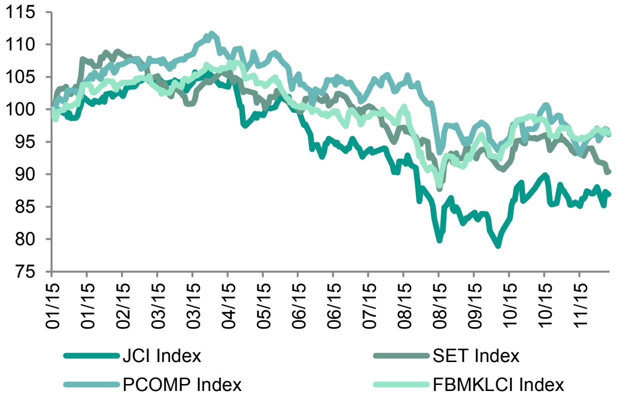


Exhibit 6: Equity indices of major ASEAN countries



Note: Baseline = Dec. 31, 2014
Source(s): Bloomberg, ABCI Securities

Exhibit 7: India's CPI and WPI difference widened in 2015

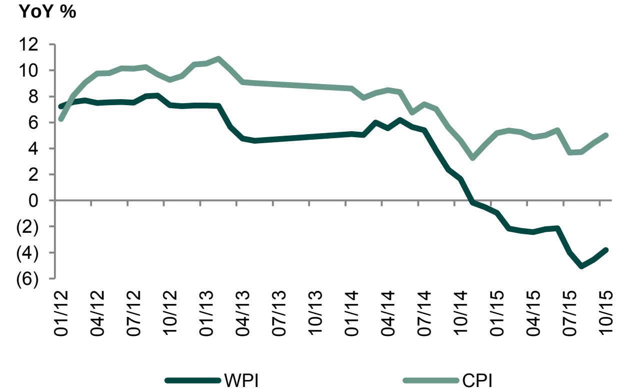
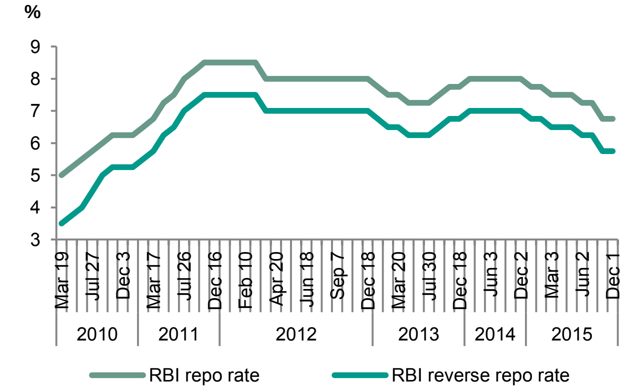


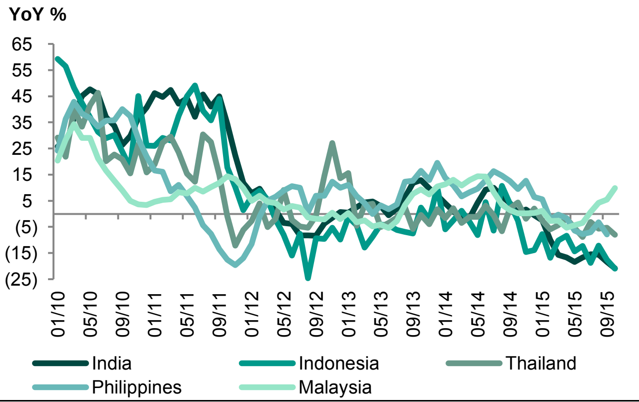
Exhibit 8: India's RBI stepped up its rate cut



Source(s): Bloomberg, ABCI Securities

Exhibit 9: Export growth of Russia

Exhibit 10: Export growth of Asian emerging countries



Source(s): Bloomberg, ABCI Securities

Exhibit 11: Brazil's iron ore export dropped

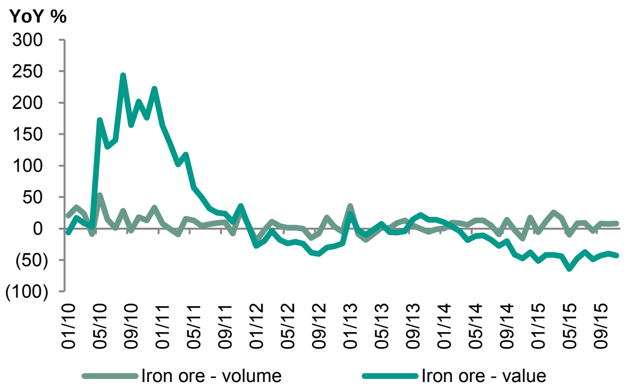
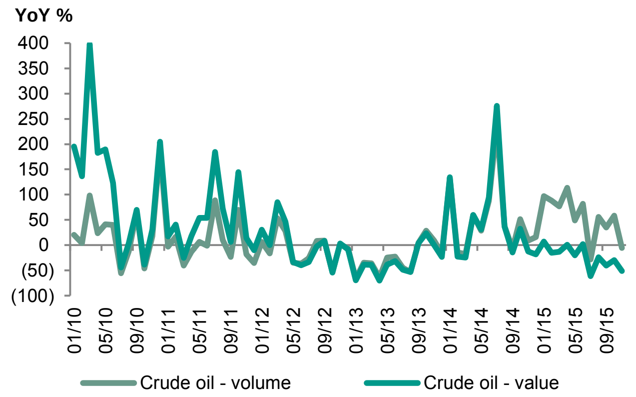


Exhibit 12: Brazil's crude oil export diverged



Source(s): Bloomberg, ABCI Securities

Exhibit 13: Brazil's total exports and exports to China faltered

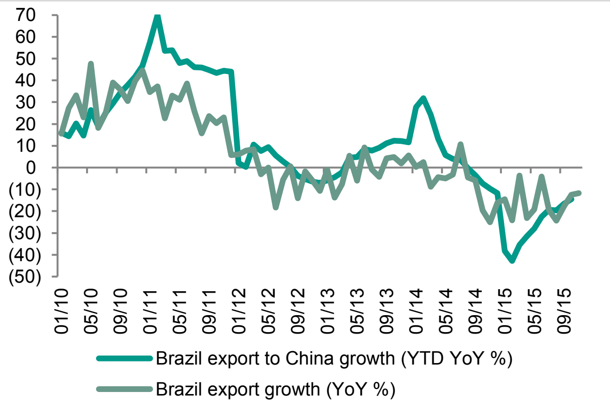
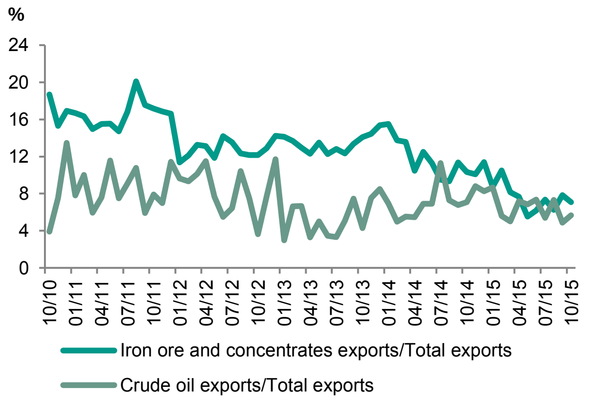


Exhibit 14: Brazil's proportion of major commodities to total exports declined



Source(s): Bloomberg, ABCI Securities

Exhibit 15: Brazil's gasoline price drives up inflation

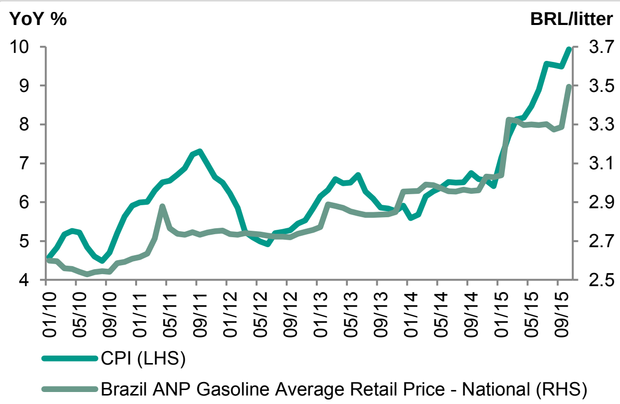
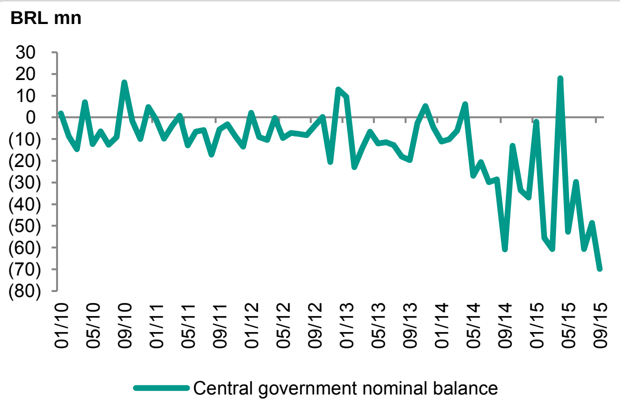


Exhibit 16: Brazil's fiscal position is deep in the red



Source(s): Bloomberg, ABCI Securities

Exhibit 17: Brazil's household debt has been climbing

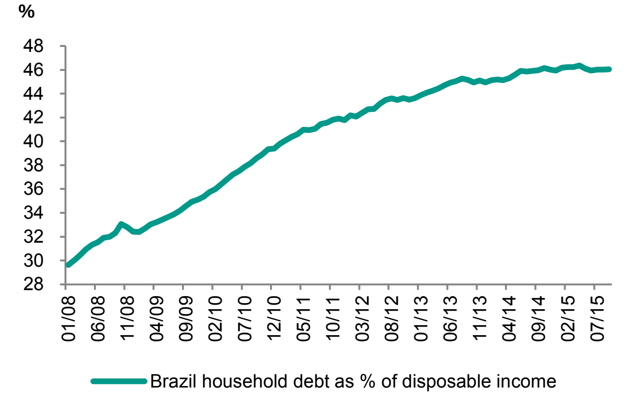
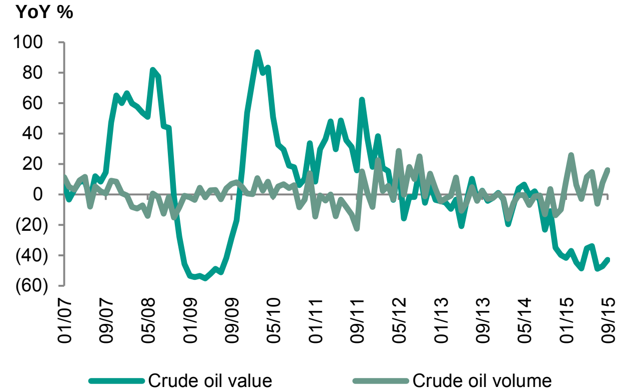


Exhibit 18: Russia crude oil export dropped in value



Source(s): Bloomberg, ABCI Securities

Exhibit 19: Russia foreign exchange and gold reserves declined

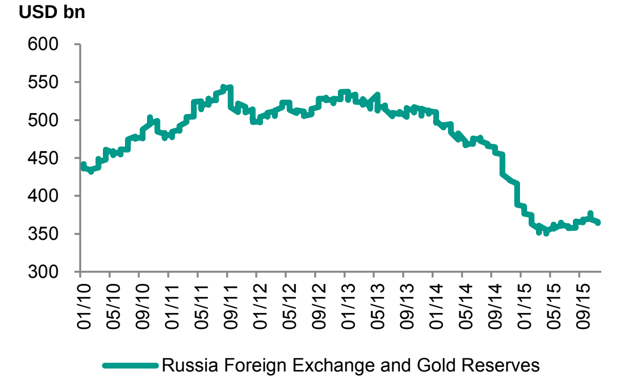
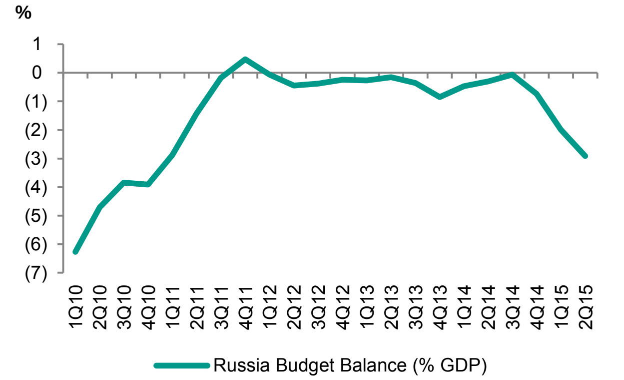


Exhibit 20: Russia's fiscal condition worsened



Source(s): Bloomberg, ABCI Securities

Exhibit 21: Russia's retail sales and inflation suffered from sanction

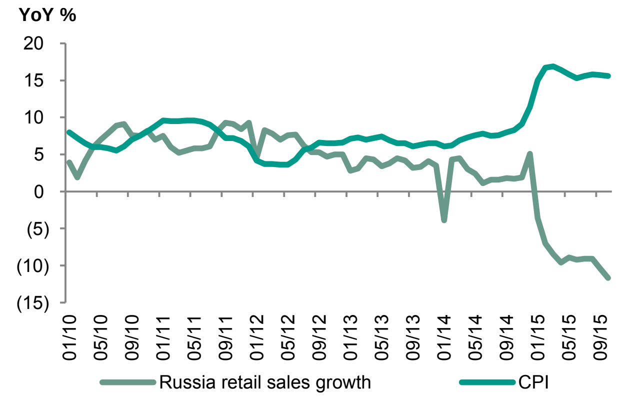
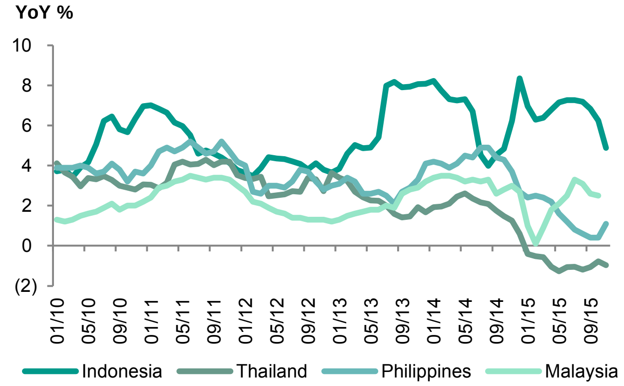


Exhibit 22: Inflation pressure is not high in most ASEAN countries



Source(s): Bloomberg, ABCI Securities

Exhibit 23: Malaysia's exports of palm oil and crude oil declined

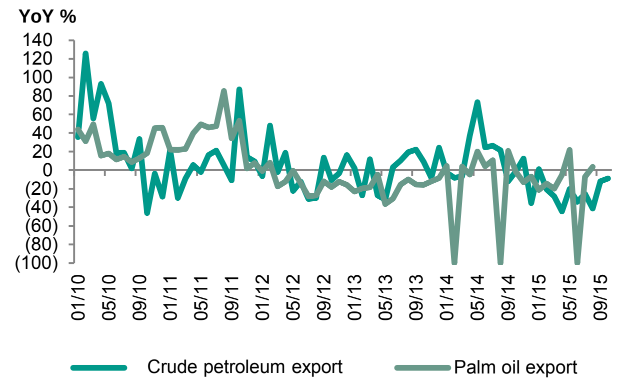
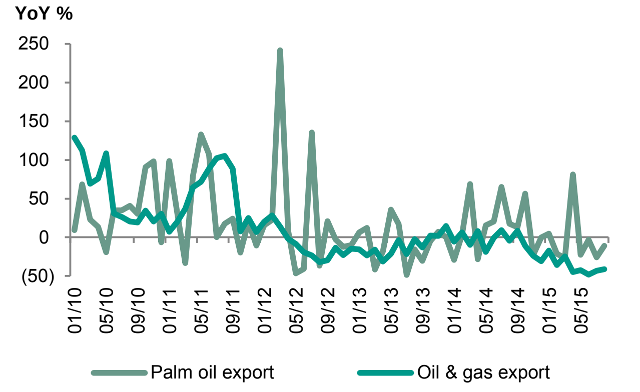


Exhibit 24: Indonesia's exports of palm oil and oil & gas declined



Source(s): Bloomberg, ABCI Securities

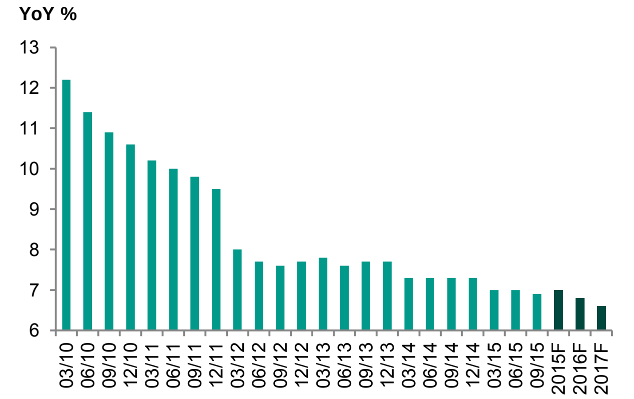
China: Turning point of structural reforms

- Momentum in the economy was sluggish in 2015 on tepid expansion in investment and consumption
- With more emphasis toward quality and efficiency, along with policy changes in areas including investment, international trade, land rights, and pricing mechanisms, China will experience a structural slowdown
- We expect China's economy growth to decline to 6.8% in 2016F to reflect the impact of structural reforms and monetary normalization in the U.S. In our view, a hard landing of the Chinese economy is highly unlikely

The year of 2015 was marked by global volatility and slowdown in economic activities in China, whose major indicators are showing unmistakable signs of moderation. Momentum in the economy was sluggish in 9M15, indicating a longer-than-expected rebalancing of the world's second largest economy. Growth in investment and consumption, the two key drivers of the economy, were the main culprits behind the weakened growth. Although China's long-term growth prospect remains solid, there will be upheavals along the way of reforms. GDP growth in 2016 will moderate as the economy is readjusting its expansion model. With more emphasis toward quality and efficiency, along with policy changes in areas including investment, international trade, land rights, and pricing mechanisms, China will experience a structural slowdown. The government will continue to implement ambitious reforms and stimulus measures, including interest rate/RRR cuts and investment incentives for strategic sectors, to boost sentiment. Although growth in most indicators will moderate, the overall macroeconomic conditions will remain stable. Entering 2016, proactive economic programs to support domestic demand and the commencement of the 13th FYP to transform China into a "moderately prosperous society" will be the keys to revive growth.

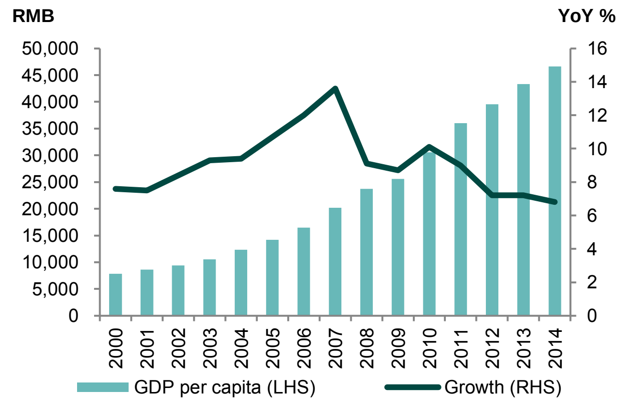
China's major economic indicators have shown clear signs of softening in the first three quarters of 2015. With growth in major GDP drivers abating and CPI stabilizing, the government will maintain an accommodative policy stance. We expect a stronger 4Q15, whose growth will be supported by accommodative fiscal and monetary measures. The current momentum points to an economic growth of 7.0% for 4Q15F, and 2015F GDP growth should reach the targeted 7%. For 2016F, we expect China's economy growth to slow to 6.8% to reflect the impact of structural reforms and monetary normalization in the U.S. In our view, a hard landing of the Chinese economy is highly unlikely.

Exhibit 1: China's economic growth



Source(s): Bloomberg, ABCI Securities estimates

Exhibit 2: GDP per capita in China



Source(s): Wind, ABCI Securities

Exhibit 3: Economic forecasts for China

YoY % (otherwise specified)	2011	2012	2013	2014	1Q15	2Q15	3Q15	2015F	2016F	2017F
Real GDP	9.2	7.7	7.7	7.3	7.0	7.0	6.9	7.0	6.8	6.6
FAI(YTD)	23.8	20.6	19.6	15.7	13.5	11.4	10.8	10.0	10.2	10.5
Retail Sales	17.1	14.3	13.1	12.0	10.6	10.2	10.8	11.5	12.0	12.5
Exports	20.3	7.9	7.9	6.1	(15.0)	(2.0)	(5.8)	(2.6)	3.5	5.5
Imports	24.9	4.3	7.3	0.4	(12.7)	(13.6)	(10.1)	(14.6)	2.5	6.5
Trade Surplus(US$bn)	155.1	231.1	259.8	382.5	123.7	139.4	142.3	606.5	644.5	662.73
CPI	5.4	2.6	2.6	2.0	1.2	1.4	1.9	1.4	1.7	2.2
PPI	6.1	(1.7)	(1.9)	(1.9)	(4.6)	(4.7)	(5.7)	(5.2)	(2.5)	1.0
M2	13.6	13.8	13.6	12.2	11.6	11.8	13.3	13.3	13.0	13.0
Exchange Rate (US$/RMB)	6.2950	6.2306	6.0543	6.2040	6.1996	6.2010	6.3571	6.4936	6.6559	6.7891

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

China policy outlook for 2016

Various proposals in the 13th FYP (2016-20) to facilitate economic and social developments were approved during the four-day plenum of the CPC Central Committee in Oct 2015. China will target a "medium-to-high economic growth" in the next five years, ensuring proper economic transformation and sustainable development. The country will proceed with economic rebalancing, promoting greater sophistication in industrial sectors and increasing the contribution of consumption to economic growth. The market-oriented reforms aim to transform China's economy into a quality-oriented one with sustainable development.

In accordance with China's economic growth and structural adjustment objectives, we expect the central government to implement accommodative monetary easing, aggressive fiscal expansion, and liberalization of exchange rate mechanism. To alleviate the intensifying downside risks, China has gone forward with a policy of loosening with liquidity injection, tax relief, greater support to enterprises, and increased infrastructure investment. Policymakers have been enhancing support for small businesses and accelerating spending of budgeted funds. China's priority will be on implementing structural adjustments in the economy to develop a "moderately prosperous society" by 2020. The following sections detail our analysis of various growth-prompting monetary and fiscal initiatives likely to take place in 2016.

1. Monetary policy: Continuation of the "moderately loose' monetary program

The People's Bank of China (PBOC) announced the sixth interest rate cut in Oct since Nov 2014 (first rate cut of 40 bps in Nov 2014; second rate cut of 25 bps in Mar 2015; third rate cut of 25 bps in May 2015; fourth rate cut of 25 bps in June 2015 and fifth rate cut in Aug 2015) by further slashing the one-year lending rate and deposit rate by 25bps each to 4.35% and 1.5%. At the same time, PBOC will further lower the reserve requirement ratio (RRR) by 50 bps for all banks, taking the ratio down to 17.5% for the biggest lenders. In general, the latest rate cut and RRR cut showed that momentum in China has remained stagnant and additional monetary easing is needed.

China's challenge in 2016 will be on maintaining a healthy credit growth while accelerating economic restructuring and sustaining its GDP growth to between 6.5% and 7%. With inflation remaining subdued, PBOC is likely to escalate credit loosening to stabilize the economy. We expect the authority to launch two rate cuts (25 bps each) and four RRR cuts (50 bps each) in 2016F. Furthermore, money supply and aggregate financing to the real economy (AFRE) will grow at a reasonable pace; meanwhile, financing and credit structures will be optimized.

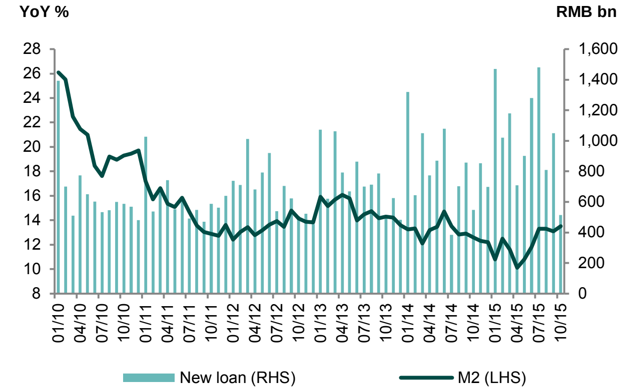
Liquidity management will continue to be a priority of monetary policy in 2H15. Considering the possible rate hike in the U.S. later this year, we believe international capital will continue to exit China. PBOC will continue to accommodate capital demand and manage temporary liquidity fluctuations in the banking system on a discretionary basis via monetary tools, including repo, pledged supplemental lending (PSL), short-term liquidity operations (SLO), medium-term lending Facility (MLF), and the standing lending Facility (SLF).

Exhibit 1: PBOC may set a lower inflation target for 2016

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
2014	3.5	2.0	Under	Prudent liquidity Management
2015F	3.0	1.4	Under	Moderately Loose
2016F	2.5	1.7	Under	Moderately Loose

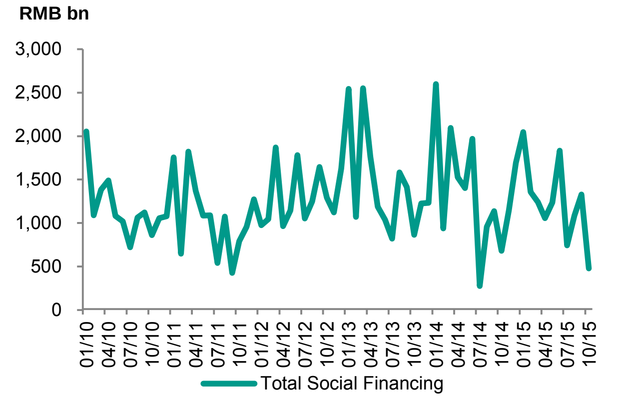
Source(s): State Council, National Bureau of Statistics, ABCI Securities estimates

Exhibit 2: China's new loan and M2 turn stable



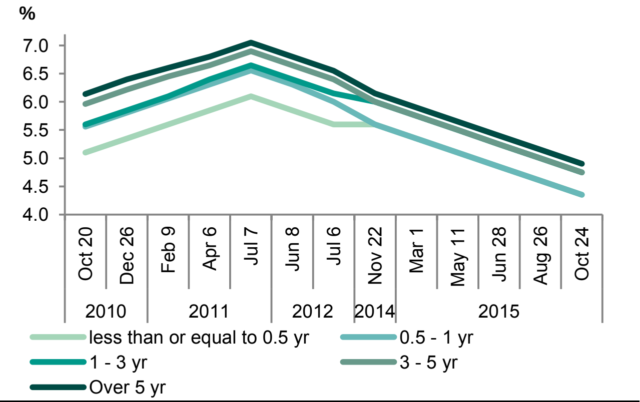
Source(s): Bloomberg, ABCI Securities

Exhibit 3: Total social financing declined in 2015



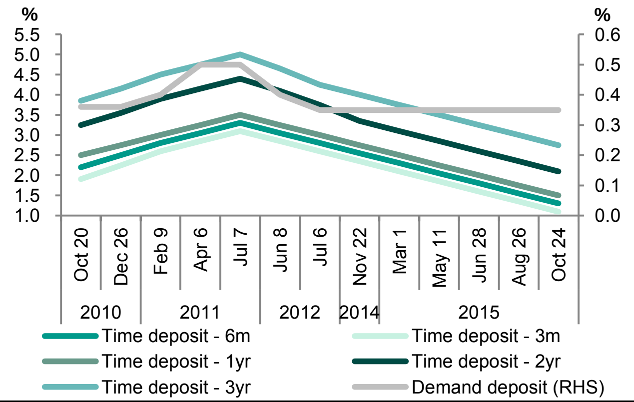
Source(s): Bloomberg, ABCI Securities

Exhibit 4: PBOC reduced loan interest rate in 2015



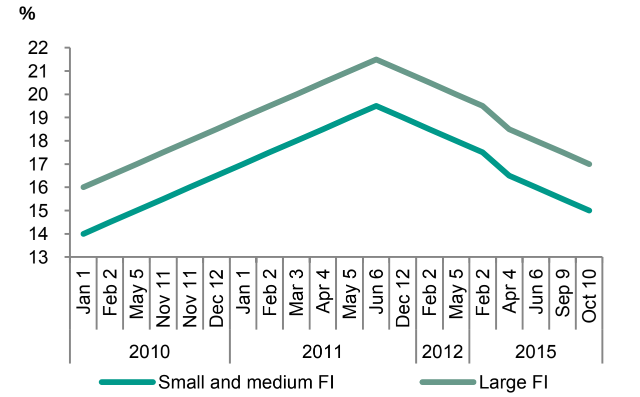
Source(s): Wind, ABCI Securities

Exhibit 5: China cut savings rates to promote interest rate liberalization and encourage consumption



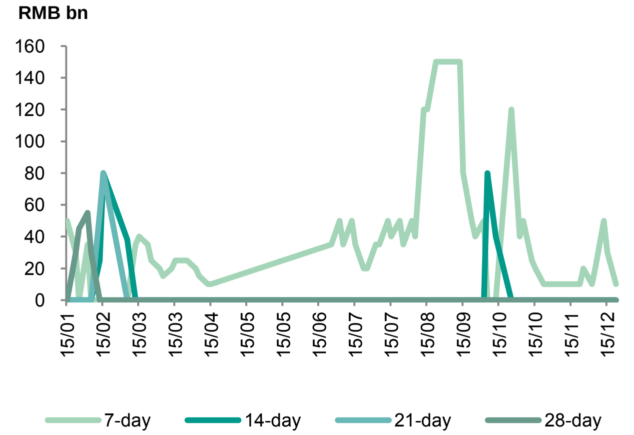
Source(s): Wind, ABCI Securities

Exhibit 6: RRR cut in 2015



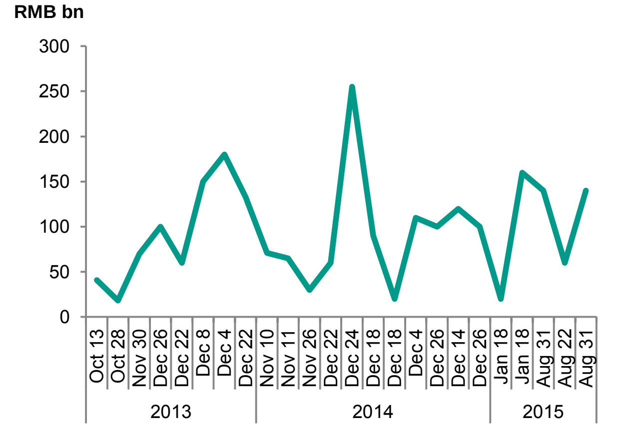
Source(s): Wind, ABCI Securities

Exhibit 7: PBOC boosted liquidity with more reverse repo in 2015



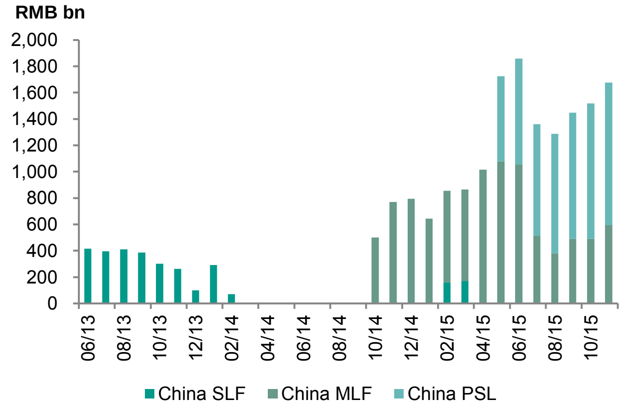
Source(s): Wind, ABCI Securities

Exhibit 8: PBOC's total SLO



Source(s): Bloomberg, Wind, ABCI Securities

Exhibit 9: PBOC's deployment of monetary tools turned frequent in 2015



Source(s): Wind, ABCI Securities

2. Fiscal policy: Boosting FAI and consumption to support growth momentum

Fiscal policy in 2016 should serve the purpose of buffering against the decelerating economy in China. To counteract the shrinking domestic demand, pro-consumption fiscal stimulus will be introduced. The nation's fiscal deficit in 2014, as a percentage of GDP, was less than 2% as compared to the 10% in the U.S. and 6% in the Eurozone. Room to expand fiscal spending is still ample, especially considering that the government is targeting for a larger fiscal deficit at 2.3% of GDP (or RMB 162bn) for 2015. We believe more support will be provided for tax relief, social housing, SMEs, livelihood-related issues and environmental protection.

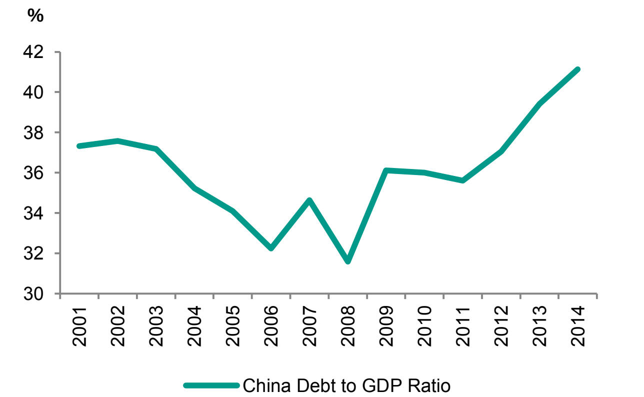
Weak economic data in 3Q15 continued to stoke fear of a prolonged slowdown in China. Nonetheless, we believe the country will maintain a healthy growth in 2016 through structural economic reforms. Expansionary fiscal policy will continue to boost FAI investment. We expect the industrial output to rebound on the back of fiscal stimulus. In general, fiscal spending on infrastructure is crucial to maintaining China's overall growth in 2016 amid slowdown in real estate, manufacturing, and other key sectors. Infrastructure investment in highways and high-speed railway construction, electricity grid upgrades, and resource development in central and western China will be supported. In addition, the central government will continue to monitor the construction of subsidized housing partially funded by the local governments. We also expect more subsidies and higher average income for low-income communities through minimum wage adjustment.

Deepening tax reform is a major fiscal measure to alleviate the financial burden of enterprises. The enhancement of tax efficiency, along with tax reductions, will boost growth in services and consumer industries. The replacement of the business tax with a value added tax (VAT) will extend to most sectors in the economy, and the consumption tax is likely to be slashed further to increase purchasing power and stimulate domestic consumption.

Special attention will be given to large-scale investment projects. To spur growth, the government has launched the "New Silk Road" initiative and set up new free-trade zones (FTZ). We believe the "New Silk Road" project will stimulate services export and help absorb part of the domestic production capacity in the industrial sector by boosting overseas demand, while the FTZ project will introduce new investment opportunities to domestic and foreign investors. Meanwhile, more resources will be devoted to the technology sector to increase employment, accelerate capital flow, and cultivate higher creativity in the society.

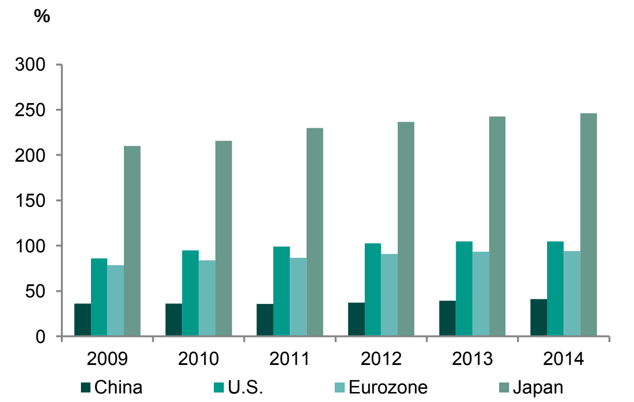
Fiscal stimulus will remain intact in 2016. We expect more aggressive stimulus packages to be rolled out in 2016, and these include: (1) acceleration in approval for infrastructure and construction projects; (2) additional subsidies on energy-efficient consumer products; (3) encouraging private capital to flow into large industrial sectors conventionally dominated by state firms with high entry barriers; (4) tax reform to support the services sector. These growth-prompting measures will work in tandem with the extended structural reforms directing the economy to increased domestic consumption and sustainability.

Exhibit 10: A healthy fiscal position to support reforms in China



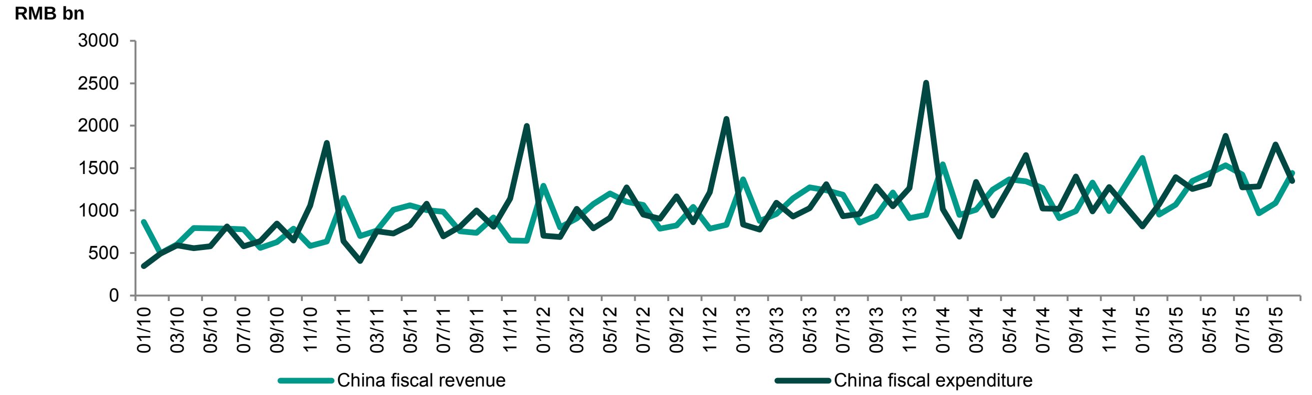
Source(s): Bloomberg, ABCI Securities

Exhibit 11: China's debt-to-GDP ratio was the lowest among the developed nations



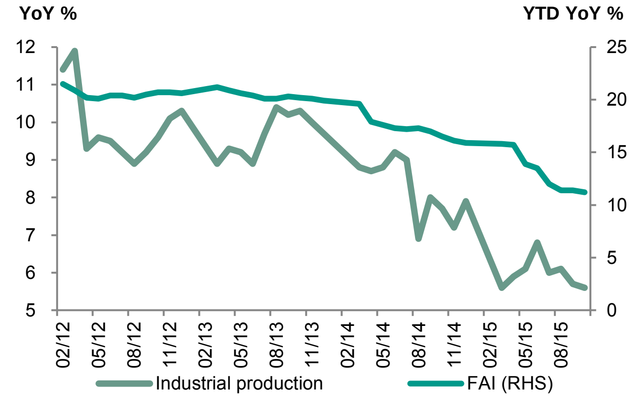
Source(s): Bloomberg, ABCI Securities

Exhibit 12: Fiscal revenue and expenses in China



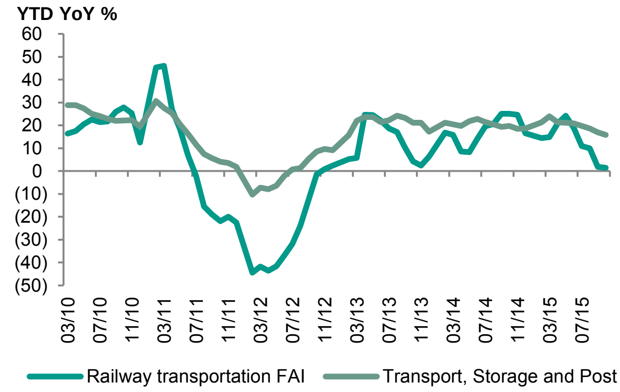
Source(s): Bloomberg, ABCI Securities

Exhibit 13: FAI & industrial production growth



Source(s): Bloomberg, ABCI Securities

Exhibit 14: FAI in transportation



Source(s): Bloomberg, ABCI Securities

3. The "new normal" of RMB

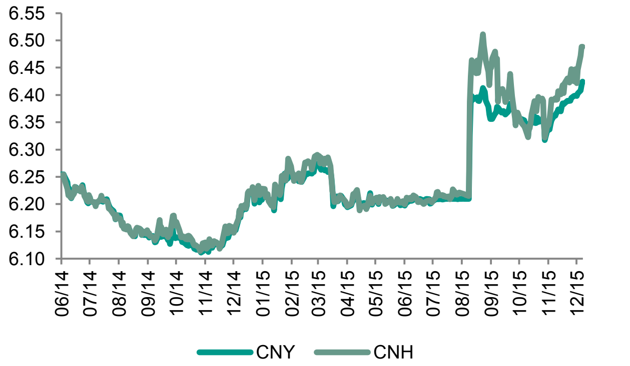
Under China's "new normal", exchange rate mechanism will undergo major changes to facilitate the internationalization of RMB. Modification of currency fixing mechanism on Aug 11, 2015 aims to bring the official midpoint exchange rate closer to that of the market, thus allowing market forces to play a greater role in determining the fair value of RMB and promoting its status as a global currency. Four months after the adjustment, the spread between on-shore rate (CNY) and offshore rate (CNH) narrowed, with the daily fixing rate settling closer to both rates. Since the adoption of the fixing mechanism, CNY and CNH have depreciated by 3.67% and 4.53% against the USD. PBOC has stated a market-based pricing mechanism for RMB is an important step of forex liberalization through the opening of capital account. The authority reassures that there exists no intention for China to pursue RMB depreciation and trigger competitive depreciation. Increasing flexibility in exchange rate can help China smoothen the shocks in the financial system and the economy. Greater exchange rate flexibility is important for China as the country strives to integrate into the global financial markets. More exchange rate reforms to enhance efficiency of the financial system will be enforced going forward.

The question remains: will the modification of RMB fixing mechanism towards a more market-oriented approach result in continuous depreciation of RMB? In developing a more flexible exchange rate system, we believe RMB may experience a few short-term fluctuations but drastic depreciation is highly unlikely. PBOC's goal is to improve its central parity system, which is the starting point for daily forex trading, to better reflect market development in the exchange rate between RMB and the USD because widening gaps among different exchange rates can disrupt the setting of an appropriate exchange rate for business transactions and asset valuation. As

China holds the largest foreign reserves in the world, we believe the value of RMB has a strong forex buffer. Hence, continuous depreciation of the currency is highly unlikely.

The inclusion of RMB into the SDR basket is regarded as a stepping stone for consolidating its global reserve currency status. The SDR recognition will grant RMB the international reserve currency status and trigger rebalancing of foreign reserves as central banks worldwide increase their holdings of RMB assets. The move will help propel RMB's internationalization and the two-way floating flexibility. In our view, greater volatility of RMB can be expected due to uncertainties surrounding the rate increase in the U.S, continued credit loosening in major economies, and moderation of China's economic momentum. Hence, we forecast the currency to fluctuate by 2.5% from 2015F level (RMB 6.4936 per USD) to RMB 6.3313-6.6559 per USD by end-2016F.

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



Source(s):, Bloomberg, ABCI Securities

Exhibit 16: RMB will join the SDR starting from Oct 1, 2016

Currency	SDR allocation (%) New	SDR allocation (%) Previous
RMB	10.92	0
USD	41.73	41.90
EURO	30.93	37.40
JPY	8.33	9.40
GBP	8.09	11.30

Source(s):, IMF,ABCI Securities

China Economic Themes

1. 13th FYP (2016-20) to turn China into a "moderately prosperous society"

To ensure that China will become a "moderately prosperous society", the government aims to double the GDP and per capita income of urban and rural residents by 2020 from the 2010 level. Consumer services sector, which includes e-commerce, medical and health, insurance, tourism, and entertainment will gain from various policy changes and outperform China's overall growth.

Exhibit 17: Highlights of proposals in the 13th FYP (2016-2020)

#	Measures
1	National governance ability to be further enhanced. Nation to be more democratic and rule of law and judicial credibility to be implemented and boosted
2	Further improving competition in natural monopoly sectors
3	Expanding the cyber economy and implementing the Internet Plus plan
4	Increased autonomy for universities and research institutes
5	Nurturing new-style professional farmers
6	Maintaining the minimum area of arable land
7	Further improvement in revenue sharing between central and local governments
8	Deepening housing reform
9	Facilitating reform in issuance and trading of stocks and bonds
10	Deepening reform of the household registration system
11	Accelerating national defense and military reform
12	Enhancing online cultural building, encouraging positive cultures in cyberspace and cleaning up the online environment
13	Promoting green finance and establishing the green development fund
14	Proposing the establishment of space planning and management system
15	Promoting new-energy vehicles
16	Implementing the most stringent management system for water resources
17	Prohibiting the transplantation of large, native trees into urban areas
18	Financial reform to be accelerated
19	The implementation of work responsibility for poverty reduction
20	Insurance rates to be lowered to reasonable level
21	Policies to be issued on raising retirement age progressively
22	Establishing a national population basic information database

Source(s): Xinhua, ABCI Securities

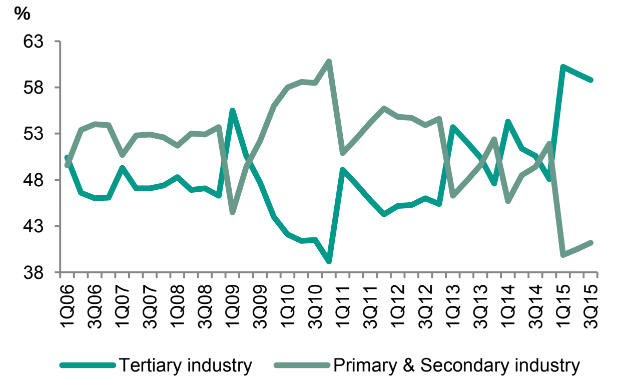
2. Higher consumption as the key GDP driver in 2016

For 1H16, higher growth will be seen in investment than consumption. The rationale is that projects approved in 2015 will commence and relevant funding will be utilized during the period. Meanwhile, fiscal policies will focus on selected infrastructure projects designed to enhance the income and welfare of rural households, which include water irrigation, agriculture, advanced equipment manufacturing, social housing, local airports in second- and third-tier cities, railways, and other large-scale projects.

In contrast with 1H16, 2H16 will see higher growth in consumption than investment. With the exception of the Chinese New Year, most Chinese festivals and holidays are in 2H. Given the slow economic growth expected in 1H16, general fiscal policies will be employed to drive consumption. Services consumption, which entails a higher margin than that of the physical goods, will be promoted. More importantly, wage growth will support consumption. Per capita disposable income of urban and rural residents increased by 6.8% YoY and 8.1% YoY in 9M15. With strong government support, we predict a 9.5% YoY increase in wages for urban households and a 14.5% increase for rural households in 2016F. Despite a slowdown in net exports, we believe the wage growth will support the GDP to expand by 6.8% for 2016F.

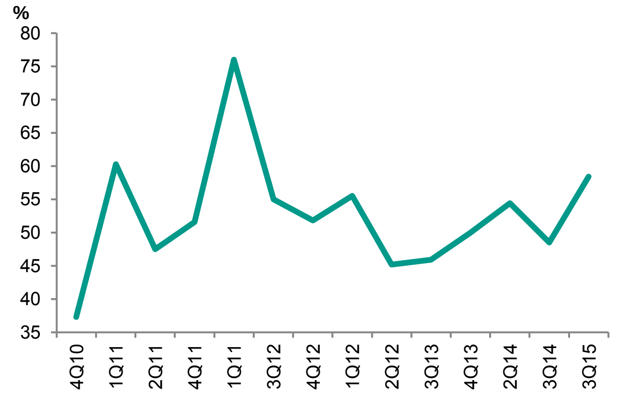
Overall, we expect retail sales growth to increase from 11.5% YoY in 2015F to 12.0% YoY in 2016F. With the support of wage growth and shift consumption pattern, consumption will play a bigger role in the economy, accounting for 51.2% of GDP growth in 2015F and over 52% in 2016F.

Exhibit 18: Higher contribution from the tertiary sector to GDP



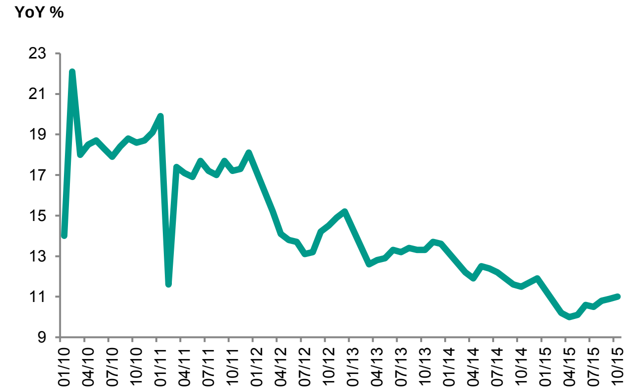
Source(s): Wind, ABCI Securities

Exhibit 19: Consumption's contribution to GDP continues to increase



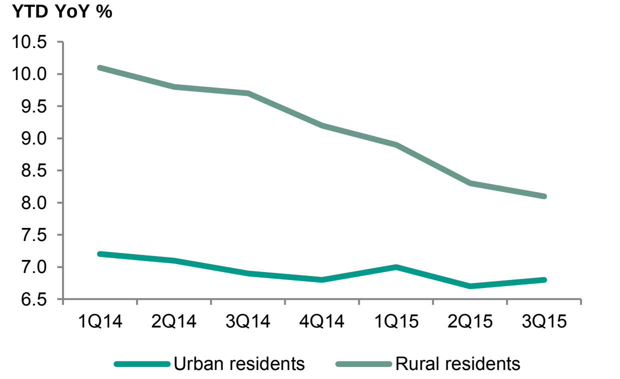
Source(s): Bloomberg, ABCI Securities

Exhibit 20: China retail sales growth declines as domestic economy slows



Source(s): Bloomberg, ABCI Securities

Exhibit 21: China disposable income per capita growth faltered



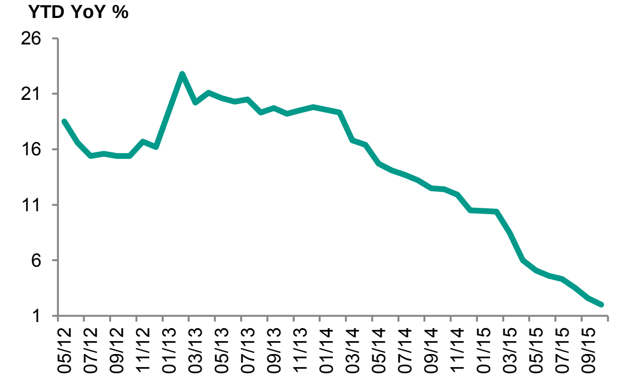
Source(s): Wind, ABCI Securities

3. Fixed asset investment: Slight moderation in 2016

We anticipate China FAI growth to accelerate slightly in 2016F (10.2% YoY) in view of (1) the large-scale government projects; (2) government-led investment in emerging industries outlined in the 13th FYP; (3) further monetary loosening in 2016 through potential cuts of RRR and interest rates. Based on the previous track record, project planning and investment would usually take place in the first two years of the FYP, to be followed by execution in the remaining years.

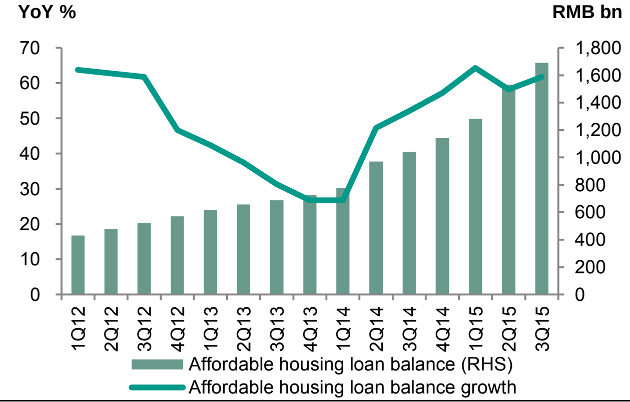
We believe investment will stay strong on increased construction of social housing in 2016 and urbanization to be expedited by enhanced support. To offset the decline in private property development, social housing plays a key role in maintaining the overall FAI growth. Positive developments in new social housing will help counteract the slowdown in private property, hence sustaining a low-single-digit growth in real estate investment for 2016. As such, we expect FAI to edge up to 10.2% in 2016F from 10.0% in 2015F.

Exhibit 22: FAI growth in real estate sector slowed



Source(s): Bloomberg, ABCI Securities

Exhibit 23: Loan balance of affordable housing investment shows strength



Source(s): Wind, ABCI Securities

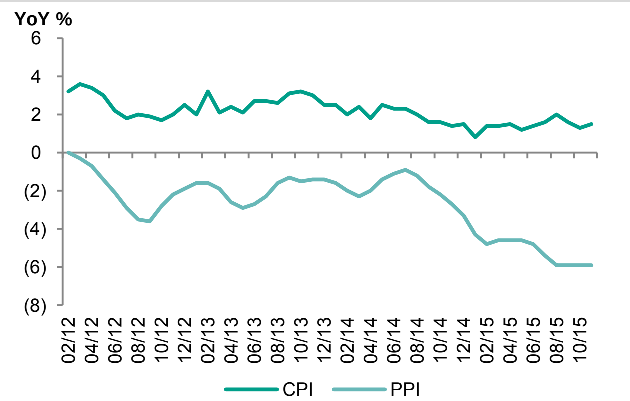
4. The implications of disinflation

Inflation has been on a downtrend since its peak in 3Q15. Coupled with general economic weakness, we believe that prices will continue to fall in 4Q15. CPI inflation in 11M15 was low at 1.4%, thus room for more credit easing is ample. Nonetheless, we expect consumption to offer some support to prices in 2016.

As inflation moderates, we believe growth in the real economy will decelerate progressively in 2016, a likely result of longer-than-expected economic rebalancing. We expect to see inflation hovering between 1.4% and 1.7% in 2016F. The slowdown will further cool demand and prices, quelling inflation further.

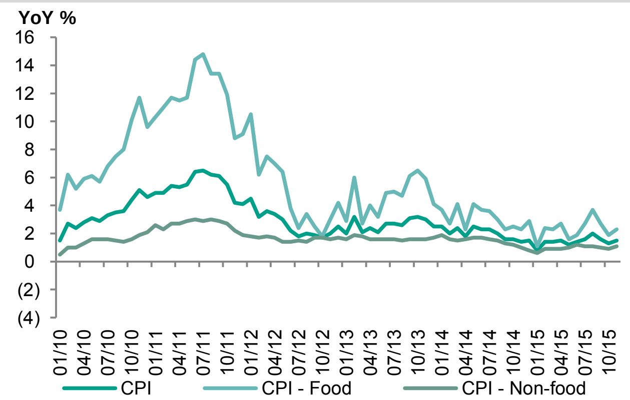
In particular, food prices will continue to trend down on government's intention to improve livelihood of rural households amid urbanization and promoting stronger consumption by rural households. As food is the major inflation driver, prices will continue to fall. Low inflation will enhance sentiment in sectors susceptible to interest rate and monetary conditions (e.g. banks, property and commodities) and those fraught with price interventions (e.g. coal, oil, and gas sectors).

Exhibit 24: Downward pressure on China's CPI and PPI



Source(s): Bloomberg, ABCI Securities

Exhibit 25: China food and non-food items' CPI



Source(s): Bloomberg, ABCI Securities

5. Services consumption to offset dampening merchandise trade outlook

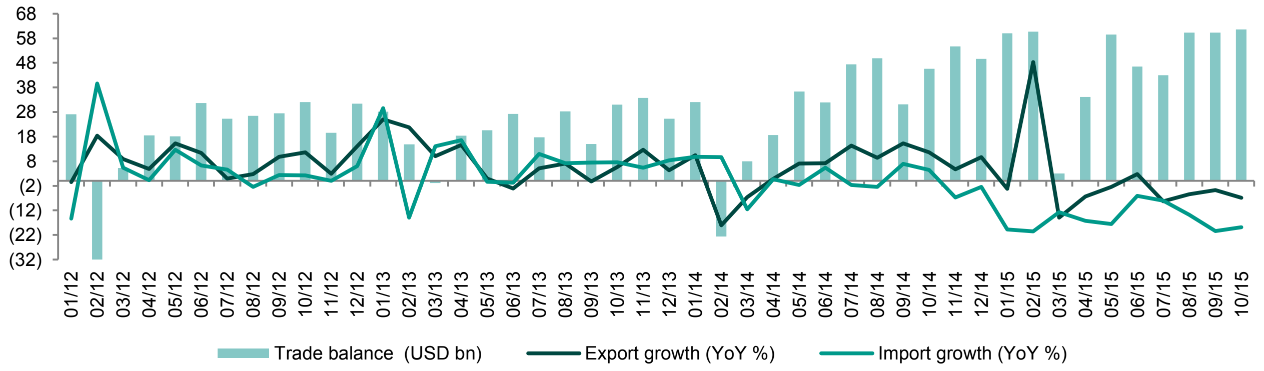
China's foreign trade has been dismal for the large part of 2015. In 11M15, exports dropped 3.0% (2.2% in RMB) while imports fell 15.1% YoY (14.4% in RMB). The decline in external trade was caused by the high base in 2014, weak external demand from the Eurozone and Japan, and tepid domestic demand. Yet, we believe growth in trade will remain stagnant in coming months on uncertain global economic outlook and external demand. Exports in 2015F are expected to decline by 2.6% YoY. With the improving economies in the U.S. and Eurozone, we forecast export and import growth to be 3.5% and 2.5% YoY for 2016F.

To combat worsening external trade, China will facilitate industry upgrades to stabilize export growth. This can be achieved by shifting its focus to manufacturing high-end, value-added products to improve profitability. The Chinese economy will also gradually shift from the consumption of goods to services. In terms of nominal GDP, we believe growth in China's services sector will outperform the manufacturing sector by 3-4% in 2016F. Such growth will be supported by the low penetration of services at present, increased pricing power of suppliers, and the government policies under the 13th FYP. Compared with the current trade of goods, China's services trade only accounted for 13.1% of its total merchandise trade in 2014, significantly lower than the global average of 19%.

Services trade is developing faster than expected. China's services trade was US$ 562.9bn in 2014, 55.3% higher than that of 2010 (US$ 362.4bn in 2010). The figure is expected to double that of 2010 to exceed US$ 650bn for 2015F/16F. China will accelerate the development of services trade by facilitating next-generation information technology, high-end equipment manufacturing, new material and alternative energy.

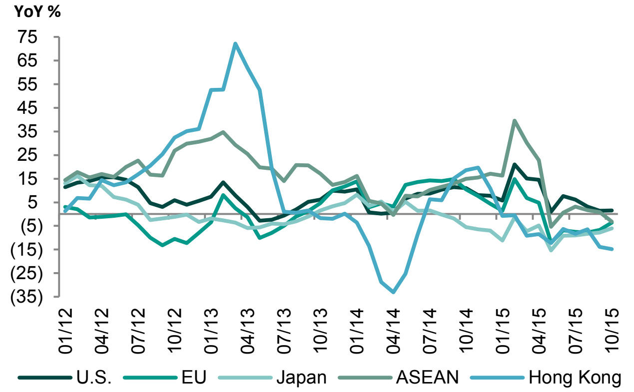
Currently, around half of the total services exports are from information-intensive sectors, including telecommunications, information services, financial services, and consultancy. Developments in areas such as tourism, construction services, information technology, shipping, aviation, railway, transportation logistics, insurance, banks, and securities and futures will increase.

Exhibit 26: China's external trade is weighed down by both domestic and global factors



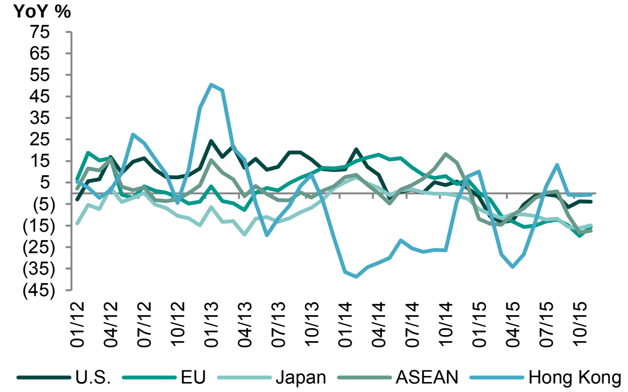
Source(s): Bloomberg, ABCI Securities

Exhibit 27: Exports to major trading partners continue to decline



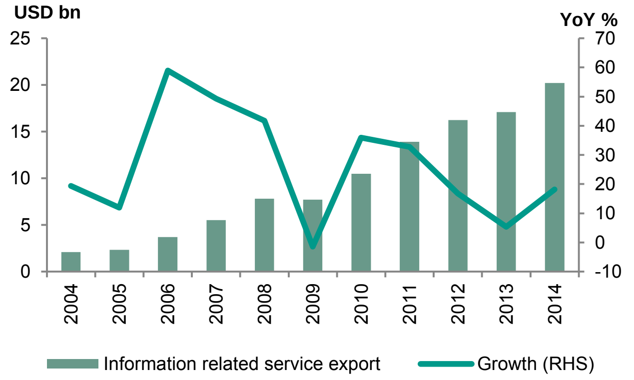
Source(s): Bloomberg, ABCI Securities

Exhibit 28: Import from major trading partners stabilized in Nov



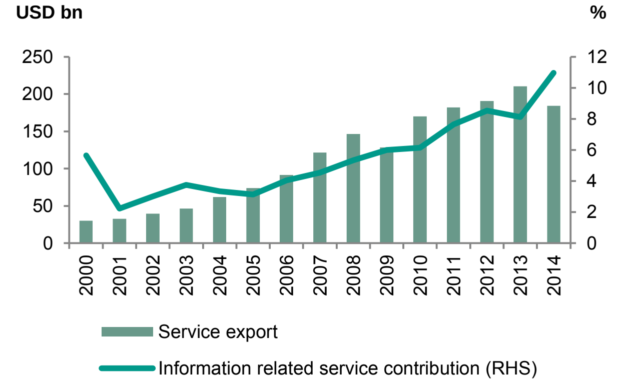
Source(s): Bloomberg, ABCI Securities

Exhibit 29: Information-related services export and growth



Source(s): Wind, ABCI Securities

Exhibit 30: Contribution of services export and information-related service to trade



Source(s): Wind, ABCI Securities

6. A more liberalized financial system in sight

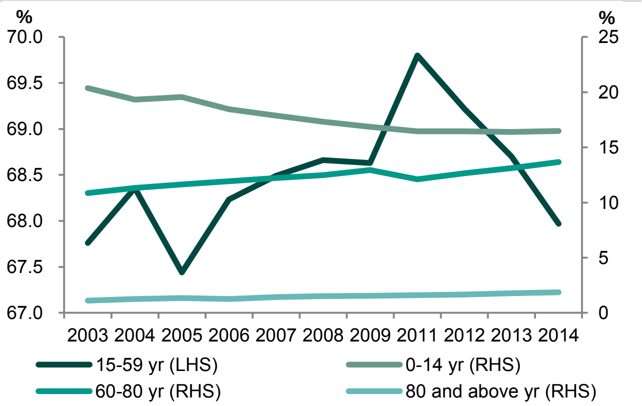
Major reforms in China's financial sector will accelerate in 2016. China will deepen reforms and establish a multi-tier capital market with proper structure, functions and regulations, efficiency, and inclusiveness. For equities, the approval-based stock issuance system will be replaced by registration-based one; the delisting regime will also be bettered. For bonds, the new guidelines will allow for the issuance of a wider and more diversified array of bonds to meet different investment needs and regulations for the market will become increasingly defined. The futures market will also diversify with the inclusion of the resource commodity futures, while approval for private equity issuance will be loosened and capital raised through private equity will be encouraged to fund small enterprises. With such extensive reforms, monitoring of the systemic risks will become crucial and authorities will toughen the punishment for breaches of laws and regulations. We are of the view that China will relax its limits on foreign investment in listed companies, expand the quotas for capital flow, and develop commodity-trading tools. The reforms will also include investment in the banking sector by private sector, development of asset securitization, liberalization of capital account, and formation of market-driven exchange rate mechanism. With the gradual removal of barriers to participate in the financial sector, China will embark further on the road to financial liberalization and develop a more robust financial system in the long run.

7. Promoting two-child policy to enhance labor productivity and optimize population structure

The 13th FYP outlines a much anticipated reform on population by further relaxing the one-child policy. In 2013, China loosened its population policy by allowing families to have a second child if one of the parents has no siblings - a change from the previous policy where parents can only have a second child if both parents are the only children. The two-child policy under the 13th FYP is a major step to promote the long-term development of population in China. According to the official statistics, share of the working-age population (aged between 15 and 64) started to decline in 2010 while the absolute size of the group shrank for the first time in 2012. This marks the end of the demographic dividend, a productive advantage brought about by a large labor force and a low dependency ratio.

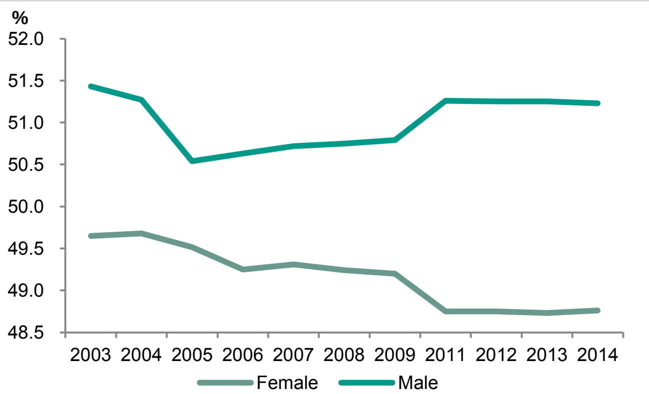
China has already begun to see the consequences of a contracting labor force. A number of provinces, especially those along the coast, have experienced labor shortages. A smaller labor force may threaten economic growth as manufacturing jobs may move to developing countries like Myanmar, Vietnam, the Philippines, and Indonesia. In addition, China's population is aging quickly. It is estimated that China's elderly population will increase to 360mn by 2030 from about 200mn in 2013. According to the United Nations, 8.5% of China's population is currently over 65, and the figure will rise to 23.9% by 2050. A change in the dependency ratio will pose a significant burden to the country in terms of healthcare expenses. The relaxation of one-child policy will help increase the working population by more than 30mn in 2050 when the baby boomers enter the labor force, raising the annual economic growth to around 0.5% to 1%. In sum, the adjusted population policy will reverse the declining growth of working population and boost the economy in the medium and long term.

Exhibit 31: Decline in working-age population has accelerated in recent years



Source(s): Wind, ABCI Securities

Exhibit 32: The persisting gender imbalance in China's population

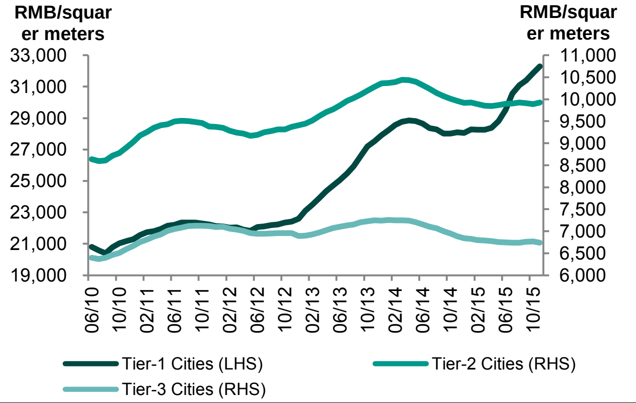


Source(s): Wind, ABCI Securities

8. Policies favoring China's property market

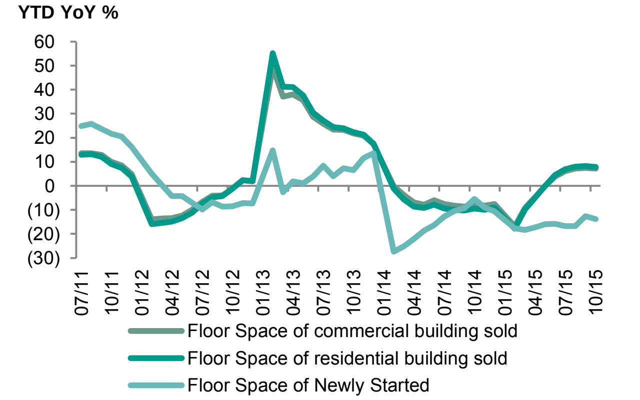
Over the past few months, China's property market has shown some strength despite of the economic slowdown. Surging housing prices and increasing sales indicate the effectiveness of policies such as the relaxation of home purchase restrictions starting from 2H14, monetary easing through rate cuts and RRR cuts, and lower down-payment requirements. Developers' financial burden is also alleviated by the issuance of local bonds at lower interest rates. Going forward, escalation of policy support may become the major catalyst for the property market. In general, sales volumes will go up steadily amid increases in mortgage availability and improved buyer's sentiment. In our view, China's property market will turn stable with a modest sales growth in 2016.

Exhibit 33: China 100-city property price index indicates room for growth of housing prices in tier-1 cities



Source(s): Wind, ABCI Securities

Exhibit 34: Recent policy to encourage property purchase may facilitate destocking



Source(s): Bloomberg, ABCI Securities

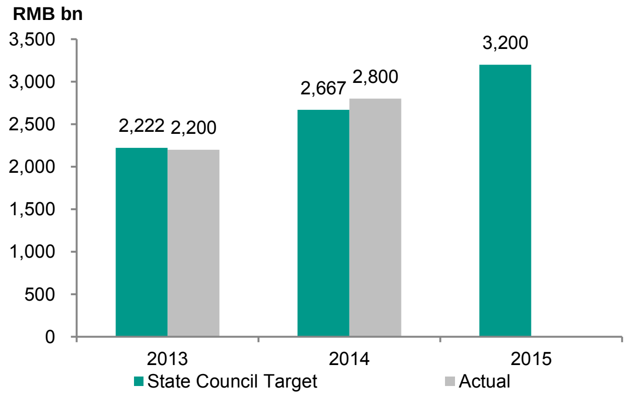
9. Services and information consumption: A robust growth driver in the coming decade

The Chinese government has been boosting domestic consumption to rebalance the economy. We believe that services consumption, primarily consumer spending on medical services, education, entertainment, tourism, household services, and financial services will be the main propellers of urban consumption growth. With the surge in residential disposable income and average household wealth, China should be able to transit to a consumption-led economy in the next decade.

The information sector is considered by the government as a new growth driver. In 10M15, foreign investment in high-tech service sector jumped 57.5% to US$ 6.76bn, indicating that surging information consumption has attracted massive foreign investment. Information consumption can serve to invigorate domestic demand, spur new growth in the economy and facilitate upgrades in the services industry. We expect the sector to expand by over 20% in the next three years, with China becoming one of the world's largest consumers in information-related products (such as e-commerce, cloud computing, and fourth-generation telecom services). To promote information consumption, however, China will need to expedite internet innovation in addition to upgrading its broadband facilities and services.

The consumer sector will see plenty of new opportunities. The "Broadband China" initiative will enable network operators to reach more consumers, including those in the remote areas. As more consumers shift to internet and mobile devices and upgrade to more advanced systems, demand for high-capacity network will rise. Network operators will also generate higher revenue from data services. This initiative to boost information consumption will benefit content and online service providers creating apps, games, and other services to the ever-expanding digital consumer market. The government will also ratchet up the integration of telecommunications, internet, and broadcasting networks into one complete system covering the entire nation.

Exhibit 35: Information consumption in China

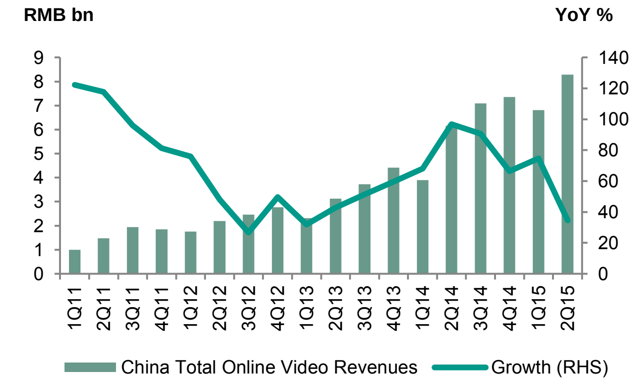


Source(s): MIIT, ABCI Securities

Exhibit 36: Online shopping in China

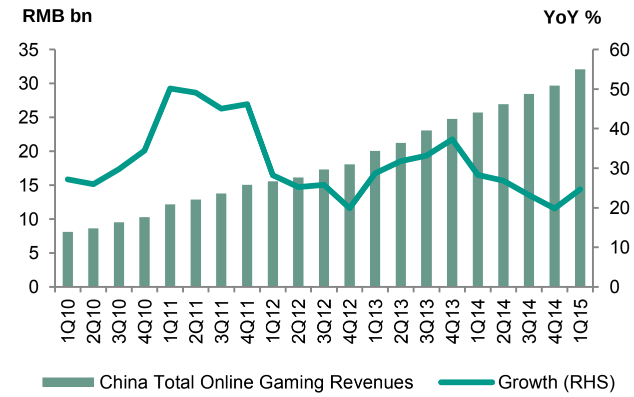
Source(s): Bloomberg, ABCI Securities

Exhibit 37: Online video revenue in China



Source(s): Bloomberg, ABCI Securities

Exhibit 38: Online gaming revenue in China



Source(s): Bloomberg, ABCI Securities

Hong Kong 2016 Economic Outlook

In 3Q15, Hong Kong's economy grew modestly by 2.3% YoY, down from 2Q15's 2.8% and 1H15's 2.6%. Unemployment rate remained low at 3.3% for the period. Inflation was slightly alleviated to 2.3% YoY, down from 2Q15's 3.0% and 1H15's 3.5%; growth in private consumption expenditures decelerated to 4.3% YoY in 3Q15, compared to 6.1% and 5.7% in 2Q15 and 1H15. Contribution of private consumption to GDP, which has been largely supported by the mainland tourists' spending in the city, fell on the economic slowdown in China, a weaker RMB, and policy to restrict multiple entries of mainland tourists to Hong Kong. Decline in retail sales growth has widened since the beginning of 2015, and we expect Hong Kong's retail sales to record only a marginal growth for the year.

Supported by infrastructure projects, investment remained strong at 2.6% YoY in 3Q15, and we expect such growth to sustain in 4Q15 and 2016. As a result of the stagnant growth in China's external trade, a still-recovering global economy, and decelerating services trade arising from reduced tourist visits, Hong Kong's exports of goods and services edged down by 2.8% YoY in 3Q15.

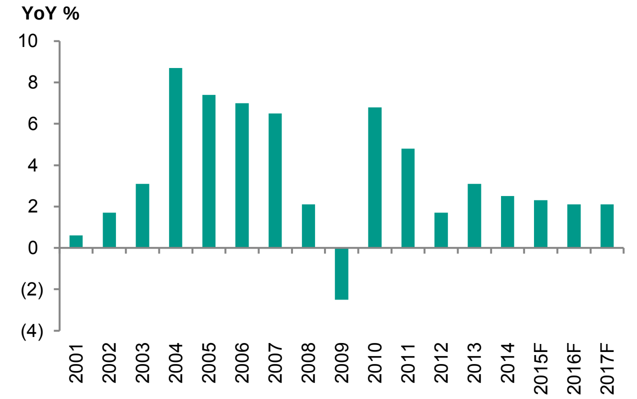
On the property front, possible U.S. rate hike in Dec will be the major headwind. We expect Hong Kong's property price will stay flat for the rest of 2015 due to surging market supply and rate hike concerns, and further downward adjustment will be seen in 2016. The launch of Shenzhen-Hong Kong Stock Connect will be a major driver supporting the stock market in 2016. Overall, we estimate Hong Kong's economy to achieve a more balanced growth at 2.3% and 2.1% for 2015F and 2016F.

Exhibit 1: Economic forecasts for Hong Kong

(YoY %, or otherwise specified)	2012	2013	2014	2015F	2016F	2017F
Real GDP	1.7	3.1	2.5	2.3	2.1	2.1
Consumption	4.1	4.6	3.2	4.7	1.9	2.1
Investment	6.8	2.6	(0.2)	2.3	3.0	1.1
Government expenditure	3.6	3.0	3.0	3.2	3.4	0.6
Exports	1.9	6.2	0.8	(1.2)	2.0	1.0
Imports	2.9	6.6	1.0	(1.0)	2.7	0.8
Unemployment rate (%)	3.3	3.4	3.3	3.4	3.6	3.7
CPI	4.1	4.4	4.4	3.0	2.7	2.5

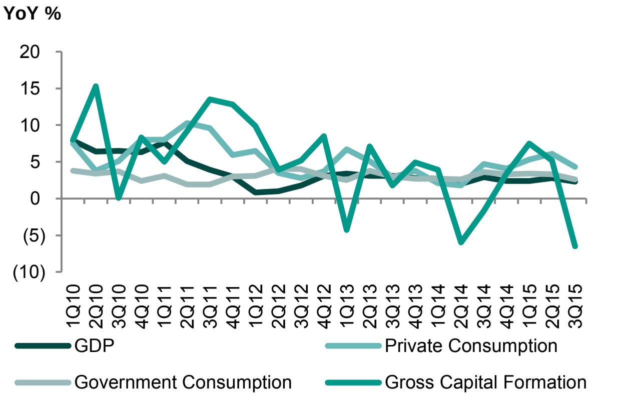
Source(s): Hong Kong Census, ABCI Securities estimates

Exhibit 2: Hong Kong's GDP growth forecasts



Source(s): Bloomberg, ABCI Securities estimates

Exhibit 3: Hong Kong's growth drivers

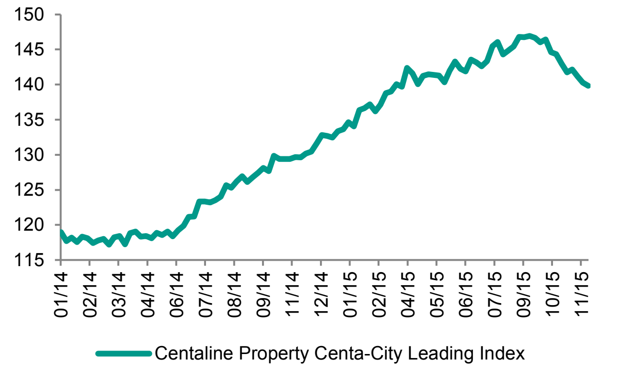


Source(s): Bloomberg, ABCI Securities

1. Property market to correct downward by 5-10%

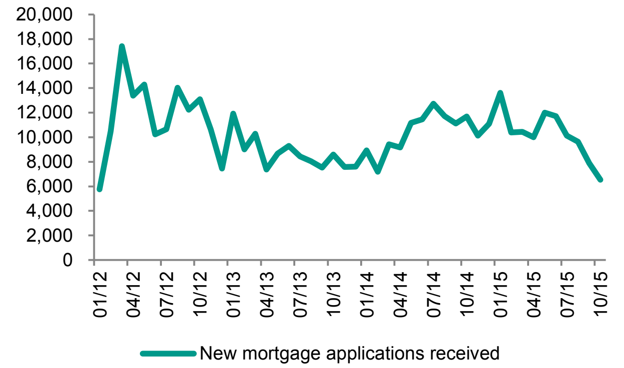
Growth in property market in 2015 moderates despite the fact that interest rates and housing supply have hit their historical lows. Alarmed by sharp increases in property prices, the government has tightened measures to stabilize the property market. With a shrinking transaction volume and the slowdown in the economy, we believe a market correction is in sight and expect property prices to decline by 5-10% for 2016F.

Exhibit 4: Property price in Hong Kong started to cool in 2015



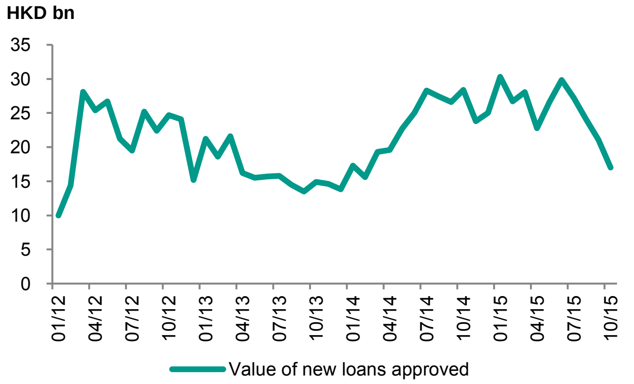
Source(s): Bloomberg, ABCI Securities

Exhibit 5: Number of new mortgage applications in Hong Kong declined



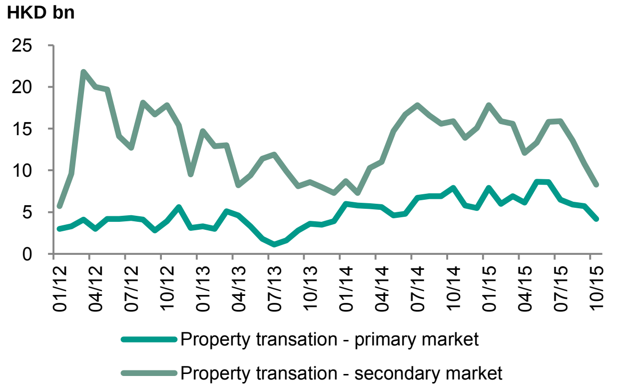
Source(s): HKMA, ABCI Securities

Exhibit 6: Total value of approved new applications decreased



Source(s): HKMA, ABCI Securities

Exhibit 7: Declining transactions in Hong Kong property market

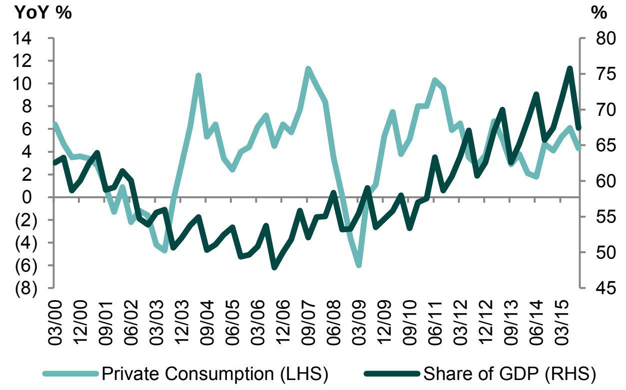


Source(s): HKMA, ABCI Securities

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

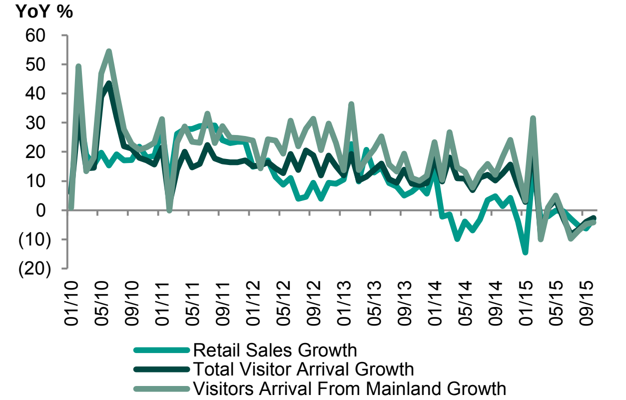
Growth in Hong Kong's economy shows signs of a slowdown as domestic demand weakened notably on the back of reduced tourist spending and a high comparison base in 2014. The number of mainland visitors declined by 0.2% YTD in Oct, compared to a 15.5% YoY growth in 10M14. YTD retail sales value dropped 2.7% 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 the positive territories, will help neutralize the decline in mainland tourist spending. We expect a low-single-digit decline in retails sales for 2015F, to be followed by a positive growth in 2016F.

Exhibit 8: Growth in private consumption expenditure remains resilient



Source(s): Bloomberg, ABCI Securities

Exhibit 9: Retail sales growth moderated in Hong Kong



Source(s): Bloomberg, ABCI Securities

3. Hong Kong will play a greater role during the 13th FYP period (2016-2010)

Hong Kong, as an international financial center, will play a greater role in promoting economic and social development as promulgated in the 13th FYP. The region's strength in human resources, financing, and connections with other countries could help the mainland enterprises explore overseas opportunities arising from the "Belt and Road" initiative. Hong Kong will also work actively to modernize its regulatory framework, strengthen investor protection, and promote the diversification of services and products.

Investment Strategy for 2016

- Systematic risk: market risks in the U.S., China and HK stock markets are relatively low in late 2015; room for further risk decline is limited
- Non-systematic risk: earnings growth momentum is weak. The market expects a mid-single-digit EPS growth in the large-cap stock indices such as DJIA, Stoxx 50, FTSE 100, SSE50 Index and HSI in 2016
- 2016 is the seeding time for China's 13th FYP, which in turn would offer long-term investors enormous opportunities
- Flat earnings growth in heavyweight financial stocks would cap the upside of HSI and HSCEI
- "New economy" stocks in IT and pharmaceutical sectors would outperform the "old economy" ones
- Leaders in oligopoly industries– insurance, telecom, nuclear power, and locomotives are likely to outperform on slowing economic growth
- We expect HSI and HSCEI to reach 23,875 and 12,271 at end-2016F

Hong Kong Stock Market

In 2015, the global economies have experienced a tepid growth. High volatility in the currency and capital markets was observed. For 2016, the global economy will remain in a low-growth phase. In 2016, depressed pricing of commodities and energy resources will continue to drive up deflationary risk while real interest rates will stay low. In the first year of the 13th FYP, we believe the Chinese government will implement the economic and political initiatives unveiled in 2015.

New initiatives to boost economy. Several major developments have taken place in the Hong Kong stock market. China has implemented new initiatives to stabilize the economy and promote economic transformation. These initiatives (such as Internet plus, one belt-one road strategy, China manufacturing 2025, new free-trade zones, SOE reformation, strengthening of China's military force, and the expectations of monetary and fiscal loosening policies) spark new investment themes. The launch of the Shanghai-Hong Kong Stock Connect in Nov 2014 has attracted investment from mainland investors in the Hong Kong stock market. For 11M15, the investment made by the mainland investors through the scheme was HK$109.5bn.While currencies in most of the developing countries have depreciated, the stability of HKD against USD and the 10.9% rise in USD index in 11M15 have lowered the foreign currency risk.

Increasing index volatility and stock market turnover. Subsequently, volatility of the benchmark indices and average daily turnover of the stock market have surged in 2015. Hang Seng Volatility Index was 21.56 on average in 11M15, against 15.95 in 2014; average daily stock market turnover rose to HK$ 108.9bn/day in 11M15, against HK$ 68.8bn in 2014. Investors have been reacting rationally, with the understanding that the investment themes aforementioned will take time to monetize or be reflected in the business results.

Total southbound transactions generated by the Shanghai-Hong Kong Stock Connect accounted for ~1.5% of total transaction value in Hong Kong stock market or 1.9% of total value of the region's equity securities turnover. The amount of investment made by mainland investors via the scheme was far less than expected. Up to Nov 30, Hang Seng Index was down 6.8%; H-share Index tumbled 18.3% YTD; red-chip Index plunged 6.9%; Hang Seng Hong Kong 35 Index (tracking 35 largest listed companies that derive the majority of business outside mainland China) eased 5.6% YTD. Meanwhile, MSCI China lost 8.9% and MSCI HK was down 4.1% YTD. On average, non-China stocks have outperformed the China-related ones. The volatility of currency delivered different return profile to different overseas investors. Based on HKD or USD, Hang Seng Index lost 6.8% YTD in 11M15, but the loss narrowed to 3.4-4.2% YTD based on RMB, GBP or JPY. Hang Seng Index was up 5.2-6.8% YTD based on Euro or AUD during the same period.

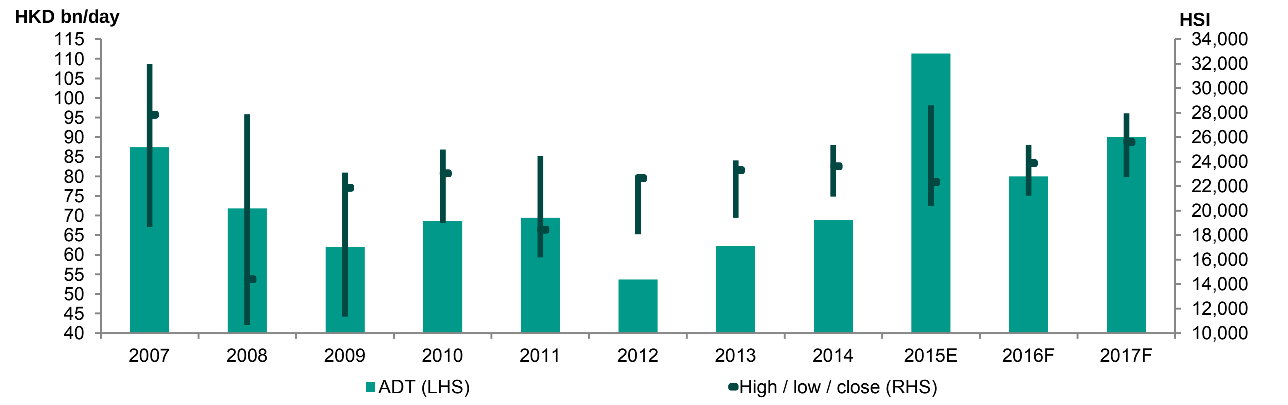
New economy outperforms the old economy. The transformation of China's economic structure has triggered institutional investors to shift their holdings to "new economy" stocks from the "old economy" ones. Among the 10 major industry sub-indices in the Hang Seng Composite Index, IT sub-index was the best-performer, advancing by 25% in 11M15; the sub-indices of energy, materials, and consumer services, which comprise the "old economy" stocks, recorded the worst performance and tumbled by 28%, 22% and 25% YTD in 11M15.

Hang Seng Index

We estimate the EPS of Hang Seng Index to decline by 19% in 2015F due to the expected EPS decline of 43%, 41% and 44% in property, coal & oil, and gambling sectors. In our view, the heavyweight China banking and China telecom stocks would post a flat growth in 2015F. China insurance and Hong Kong-based banking sectors would deliver a moderate profit growth.

The trading range of Hang Seng Index in 11M15 was 20,368.12-28,588.52, representing 10.20-14.32x of 2015F P/E, 1.08-1.51x 2015F P/B, and a 2015F dividend yield of 2.78-3.9%. We estimate the average daily turnover of Hang Seng Index to be HK$ 33.2 bn/day in 2015F, up 29.4%YoY, representing 30% of daily stock market turnover in the Mainboard. We predict the daily stock market turnover in the Mainboard to be HK$108.0 bn/day in 2015F, up 57% YoY.

Exhibit 1 : Hang Seng Index (high/low/close) and average daily stock market turnover



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

Looking forward, we expect the earnings growth of Hang Seng Index to be 5.5% for 2016F. The Hang Seng index is dominated by the "old economy" stocks that are unable to reflect China's transforming economic structure toward advanced technology and services. The new economy" stocks, such as mobile Internet services providers and mobile telecom companies should benefit from surging demand. Earnings growth of heavyweight China banking stocks would remain flat. China property stocks would benefit from the falling interest rate cycle in China while its Hong Kong counterparts may suffer from rising interest rate cycle in Hong Kong and the U.S.

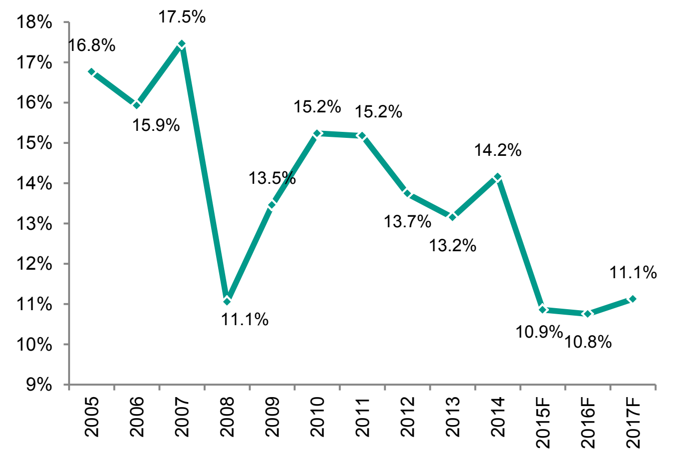
For 2016F, combining the P/E, P/B and dividend yield valuations, the trading range of the Hang Seng Index would be 21,234-25,376, which represents 10.08-12.04x FY16F P/E, 1.05-1.25x FY16F P/B, and a FY16F dividend yield of 3.91-3.27%. We set our end-2016F target at 23,875, which represents 11.33x FY16F P/E, 1.18x FY16F P/B, and a FY16F dividend yield of 3.48%. We estimate the average daily stock market turnover in the Mainboard will reduce by 26%YoY to HK$80.0 bn/day in 2016F.

Exhibit 2: Projected trading range of HSI in 2016F

Method	Valuation band range in 2016E			Corresponding	HSI trading range	
1	P/B high	P/B low	End-2016F	**Index high**	**Index low**	**End-2016F**
	1.25	1.05	1.20	25,307	21,258	**24,295**
2	P/E high	P/E low	End-2016F			
	12.00	10.00	11.50	25,288	21,074	**24,235**
3	Yield low	Yield high	End-2016F			
	3.25%	3.88%	3.59%	25,533	21,371	**23,094**
			Average	**25,376**	**21,234**	**23,875**
			Implied '16 P/E	12.04	10.08	**11.33**
			Implied '16 P/B	1.25	1.05	**1.18**
			Implied '16 yield	3.27%	3.91%	**3.48%**

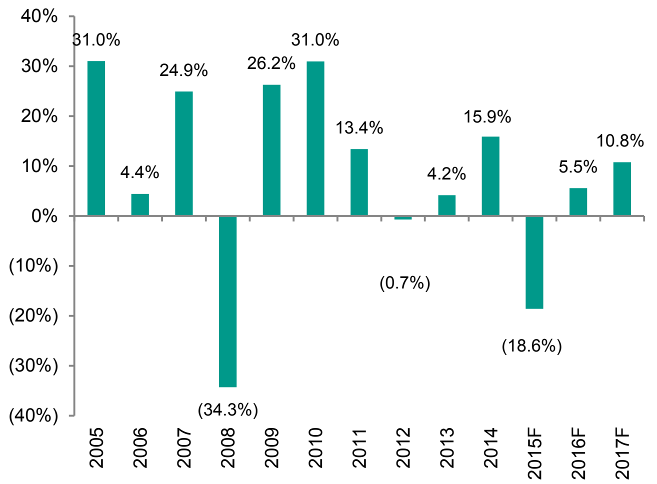
Source(s): ABCI Securities estimates

Exhibit 3 : HSI's ROAE



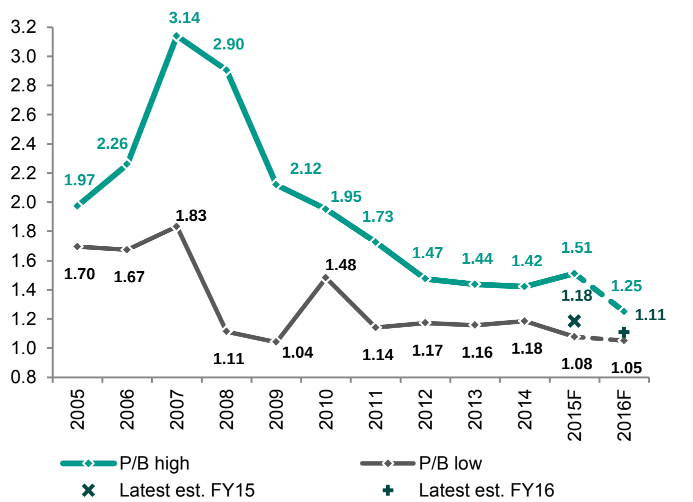
Source(s): ABCI Securities estimates

Exhibit 4 : HSI's EPS growth



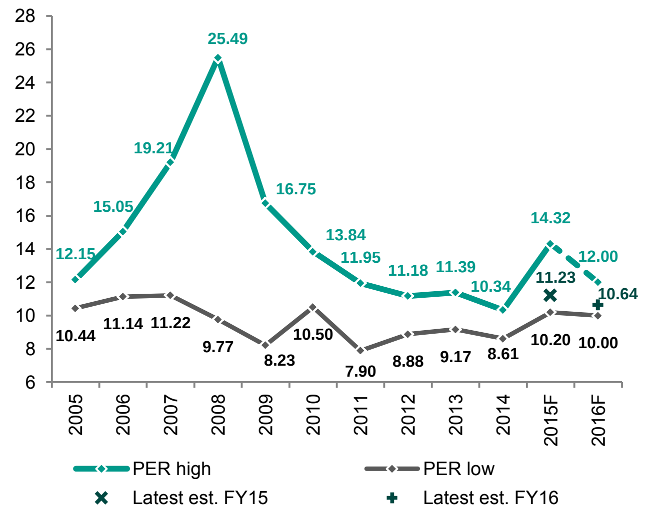
Source(s): ABCI Securities estimates

Exhibit 5: HSI's P/B band (Index: 22,010)



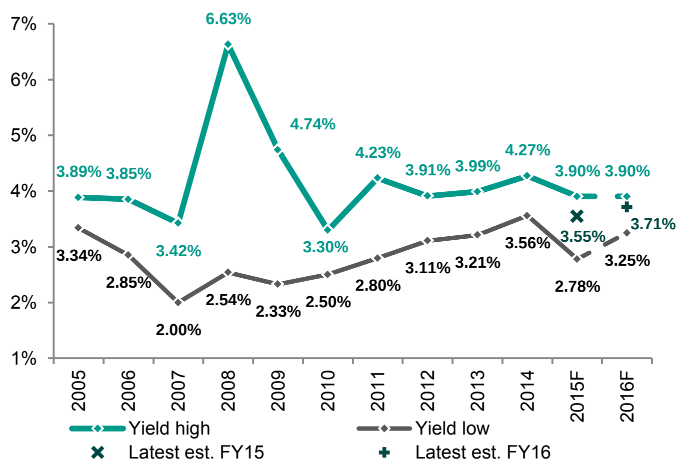
Source(s): ABCI Securities estimates

Exhibit 6: HSI's P/E band (Index: 22,010)



Source(s): ABCI Securities estimates

Exhibit 7: HSI's dividend band (Index: 22,010)



Source(s): ABCI Securities estimates

Hang Seng China Enterprises Index

We estimate the EPS of Hang Seng China Enterprises Index (or HSCEI) to decline by 6% in 2015F due to the expected EPS decline of 46% and 41% in coal & oil and base materials sectors. Heavyweight China banking stocks are expected to deliver a flat EPS growth; meanwhile, China insurance and brokerage stocks would post an EPS growth of 35% and 69%.

The trading range of Hang Seng Index in 11M15 was 9,058.54-14,962.74, representing 6.81-11.24x 2015F P/E, 0.88-1.46x 2015F P/B, and a 2015F dividend yield of 2.68-4.42%. We expect the average daily turnover value of HSCEI member stocks to be HK$ 22 bn/day in 2015F, up 57%YoY.

Stocks in the sectors of Chinese financials (including banking, insurance, securities brokerage and asset management), energy & power, property & construction, and automobile & locomotive accounted for around 70.4%, 14.3%, 6.1% and 4.8% of HSCEI. Based on our estimates, the Chinese financials in the index would post a weighted average EPS growth of 3.4% for 2016F; whereas energy & power would have a weighted average EPS growth of 9.7% for 2016F. With the continued recovery of housing and auto markets since 2H15, a strong rebound in the property & construction and the automobile & locomotive is likely in 2016. EPS growth in Property & construction would be 18% for 2016F while the automotive & locomotive would deliver a 12% YoY growth. HSCEI's EPS growth for 2016F is expected to be 4.0% YoY.

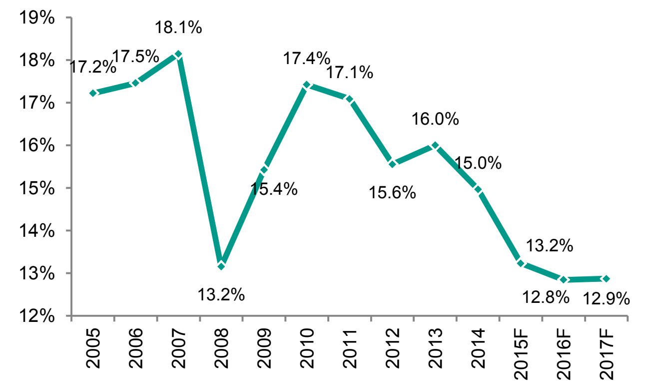
For 2016F, the trading range of the HSCEI Index was estimated to be 8,993-13,725, which represents 6.43-9.82x FY16F P/E, 0.79-1.21x FY16F P/B, and a FY16F dividend yield of 4.69-3.07%. We set the end-2016F target at 12,271, which represents 8.78x FY16F P/E, 1.08x FY16F P/B, and a FY16F dividend yield of 3.44%.

Exhibit 8: Projected trading range of HSCEI in 2016F

Method	Valuation band range in 2016E			Corresponding HSI trading range		
1	P/B high	P/B low	End-2016F	**Index high**	**Index low**	**End-2016F**
	1.30	0.88	1.20	13,400	9,059	**12,369**
2	P/E high	P/E low	End-2016F			
	10.00	6.70	9.00	13,384	8,967	**12,046**
3	Yield low	Yield high	End-2016F			
	2.80%	4.50%	3.25%	14,390	8,954	**12,397**
			Average	13,725	8,993	**12,271**
			Implied '16 P/E	9.82	6.43	**8.78**
			Implied '16 P/B	1.21	0.79	**1.08**
			Implied '16 yield	3.07%	4.69%	**3.44%**

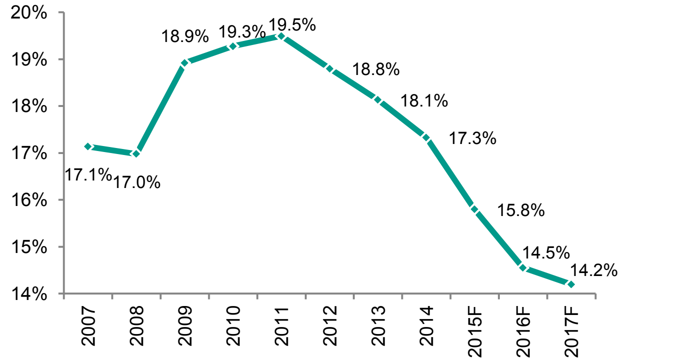
Source(s): ABCI Securities estimates

Exhibit 9: HSCEI's ROAE



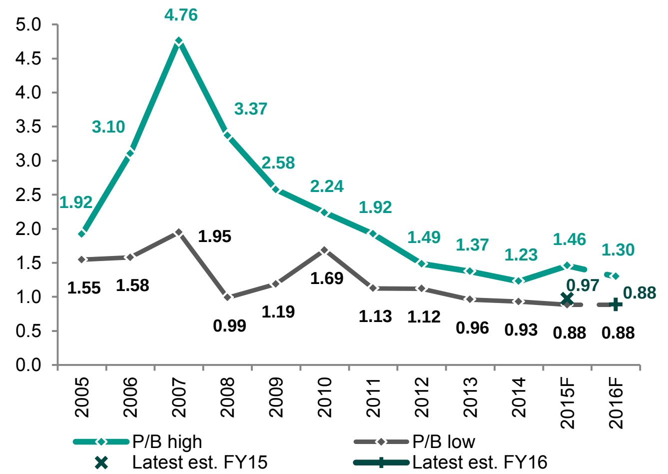
Source(s): ABCI Securities estimates

Exhibit 10: H-Fin Index's ROAE



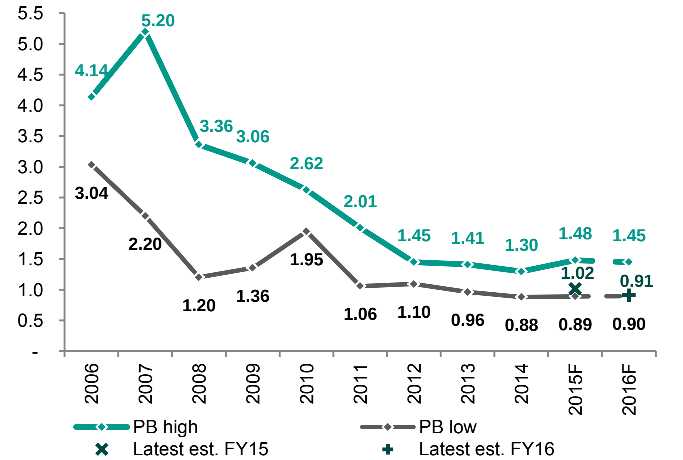
Source(s): ABCI Securities estimates

Exhibit 11: HSCEI's P/B band (Index: 9,988)



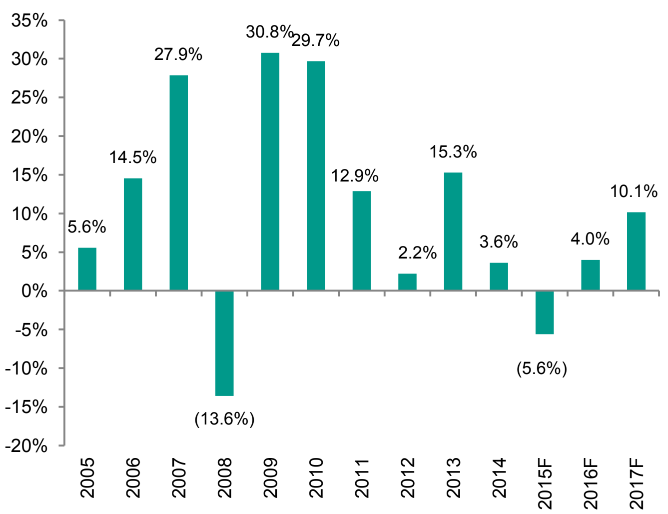
Source(s): ABCI Securities estimates

Exhibit 12: H-Fin Index's P/B band (Index: 16,033)



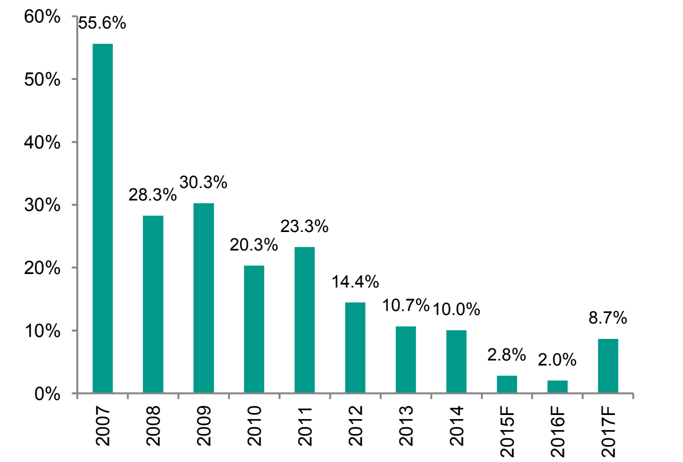
Source(s): ABCI Securities estimates

Exhibit 13: HSCEI's EPS growth



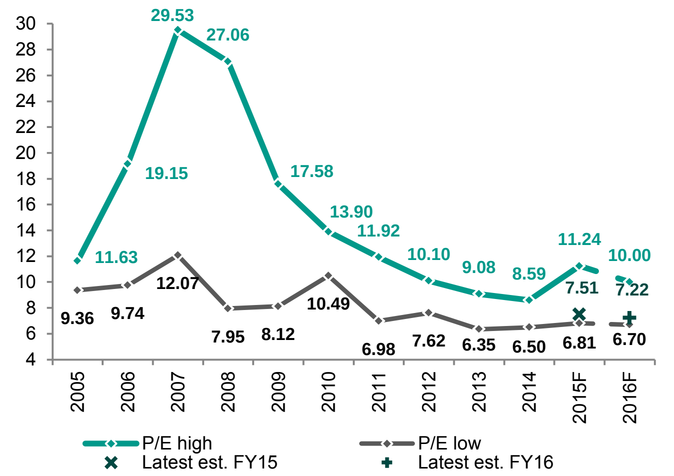
Source(s): ABCI Securities estimates

Exhibit 14: H-Fin Index's EPS growth



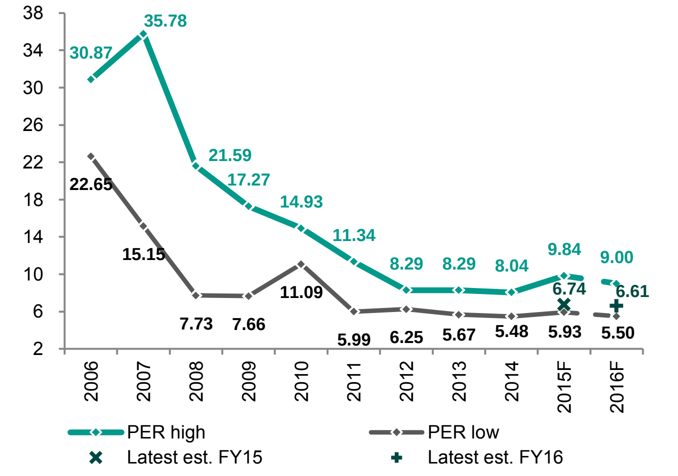
Source(s): ABCI Securities estimates

Exhibit 15: HSCEI's P/E band (Index: 9,988)



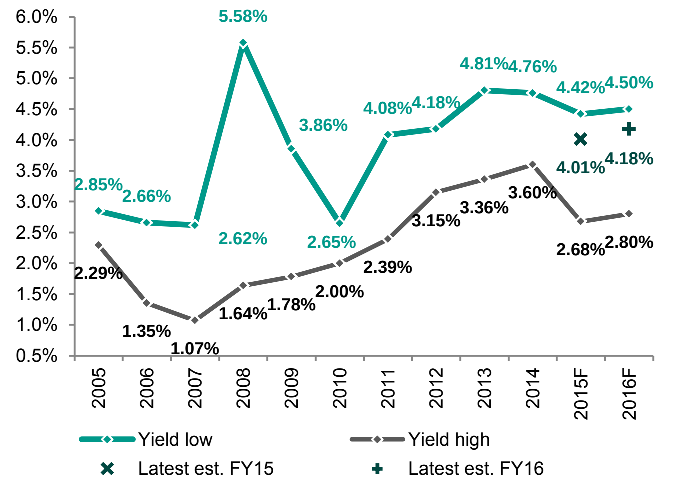
Source(s): ABCI Securities estimates

Exhibit 16: H-Fin Index's P/E band (Index: 16,033)



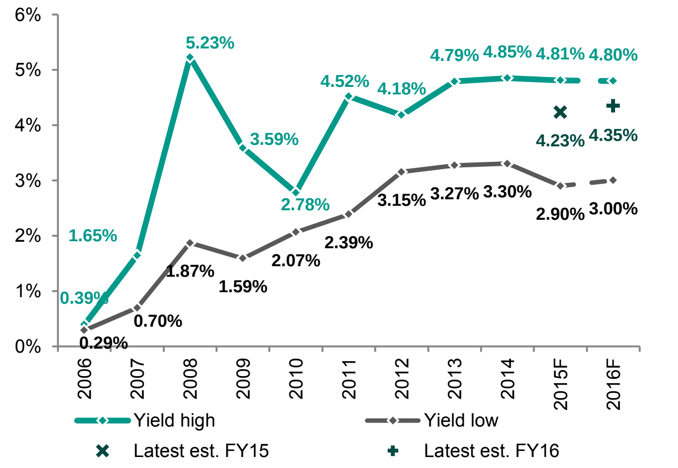
Source(s): ABCI Securities estimates

Exhibit 17 HSCEI's dividend yield band (Index: 9,988)



Source(s): ABCI Securities estimates

Exhibit 18: H-Fin Index's dividend yield band (Index: 16,033)



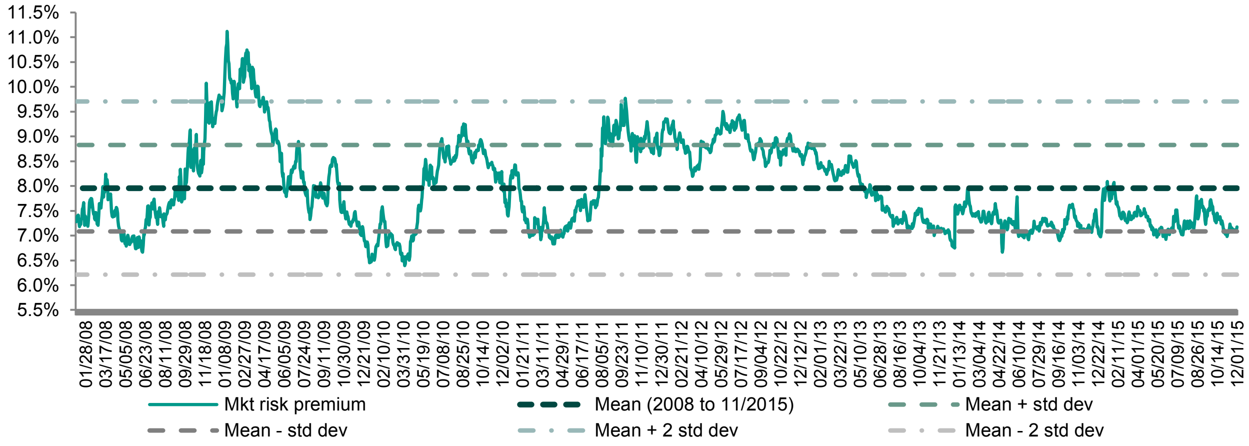
Source(s): ABCI Securities estimates

Market risk trend since 2008

After the market correction in mid-2015, risk premium in the U.S., China and Hong Kong stock markets has edged up to the range of 1 S.D below the mean. Currently, market risk is not significantly underestimated and therefore stock valuation is not substantially overinflated. However, the market is not undervalued either.

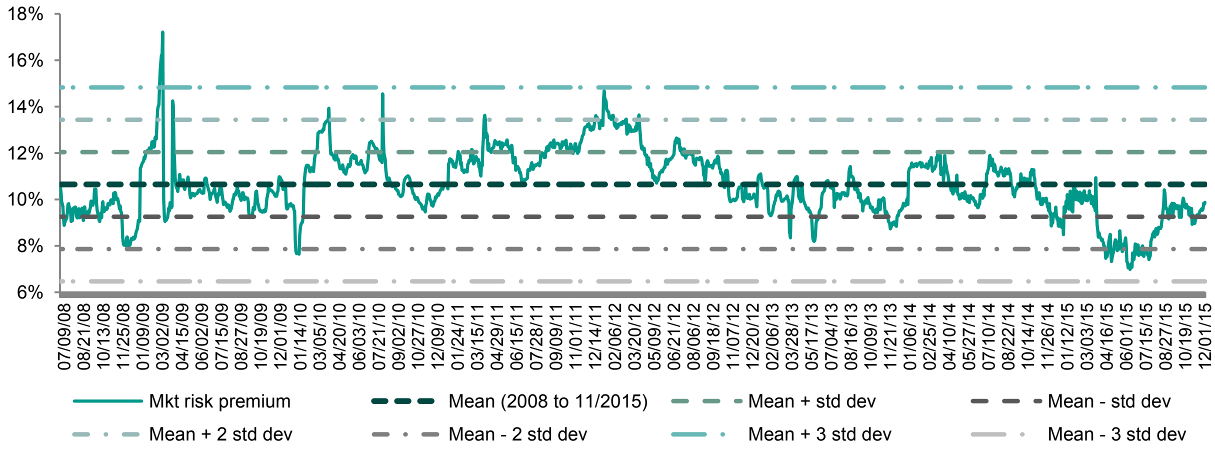
The chance of substantial decline in market risk premium will be low in 2016. Hence, stock valuation is less likely to be boosted by the decline in market risk. Instead, non-systematic risks will become a major swing factor affecting stock valuation.

Exhibit 19 : U.S. stock market risk premium (1/2008- 11/2015)



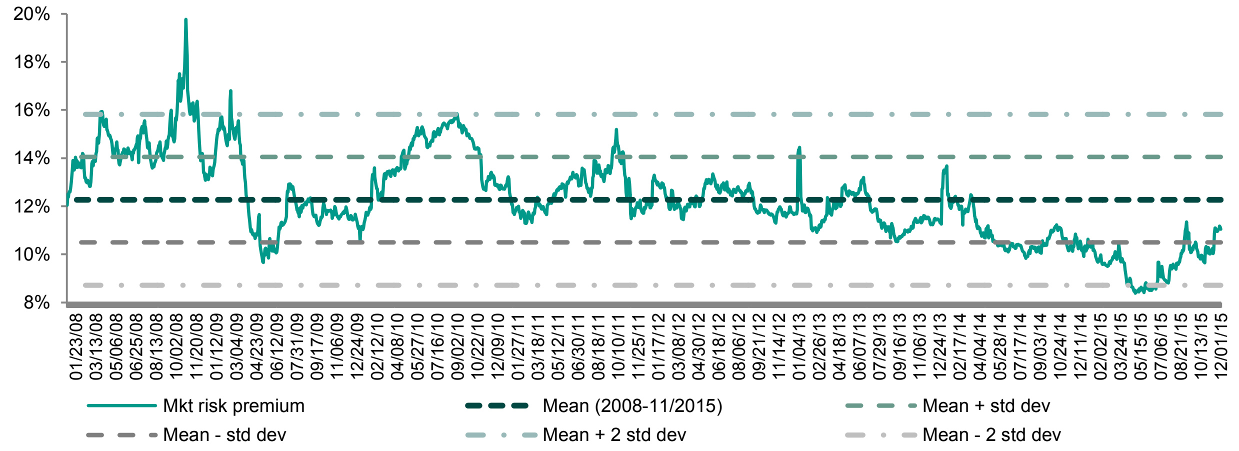
Remark: Average risk premium (2008-2015): 7.96%; standard deviation: 0.87%; current risk premium: 7.07%
Source(s): Bloomberg, ABCI Securities

Exhibit 20 : China stock market risk premium (1/2008- 11/2015)



Remark: Remark: Average risk premium (2008-2015): 10.65%; standard deviation: 1.39%; current risk premium: 9.88%
Source(s): Bloomberg, ABCI Securities

Exhibit 21 : Hong Kong stock market risk premium (1/2008- 11/2015)



Remark: Average risk premium (2008-2015): 12.28%; standard deviation: 1.78%; current risk premium: 10.17%

Source(s): Bloomberg, ABCI Securities

Exhibit 22: Market Valuation of Hang Seng Index Stocks

Ticker	Company name	Price (HK$)	2017F P/E (x)	2017F PEG (x)	2017F P/B (x)	2017F Yield (%)	2017F ROAE (%)	2016F P/E (x)	2016F PEG (x)	2016F P/B (x)	2016F Yield (%)	2016F ROAE (%)	2015E P/E (x)	2015E P/B (x)	2015E Yield (%)	2015E ROAE (%)
2	CLP HLDGS	65.00	13.71	3.48	1.59	4.30	11.8	14.21	3.60	1.66	4.15	11.9	14.81	1.73	3.98	12.1
3	HK CHINA GAS	15.40	20.05	2.45	2.73	2.58	14.1	21.51	2.62	2.92	2.41	14.0	23.48	3.10	2.21	13.8
6	POWER ASSETS	69.90	18.31	7.45	1.19	2.73	6.6	18.62	7.57	1.21	2.69	6.5	19.22	1.20	2.60	6.3
836	CHINA RES POWER	15.26	5.75	(8.33)	0.76	7.00	13.8	5.98	(8.67)	0.83	6.73	14.5	5.67	0.91	7.09	17.0
1113	CHEUNG KONG PROP	52.90	9.93	0.85	0.72	3.02	7.5	10.59	0.91	0.76	2.83	7.3	12.39	0.80	2.42	9.3
101	HANG LUNG PROP	18.34	13.39	18.14	0.58	2.18	4.4	13.72	18.59	0.59	2.12	4.4	13.59	0.61	2.14	4.5
1109	CHINA RES LAND	22.55	8.16	0.53	0.99	2.41	12.7	9.34	0.60	1.08	2.10	12.2	10.88	1.20	1.80	11.7
12	HENDERSON LAND D	48.00	15.04	8.27	0.60	1.30	4.1	15.44	8.49	0.62	1.27	4.1	15.59	0.64	1.26	4.2
16	SHK PPT	97.10	10.45	2.66	0.57	2.89	5.5	10.95	2.78	0.58	2.76	5.4	11.29	0.60	2.67	5.4
17	NEW WORLD DEV	7.84	9.17	2.47	0.33	2.11	3.7	9.63	2.60	0.36	2.01	3.9	9.86	0.39	1.96	4.0
4	WHARF HLDG	44.40	10.17	1.39	0.41	1.50	4.1	10.82	1.48	0.42	1.41	3.9	11.72	0.43	1.30	3.7
688	CHINA OVERSEAS	27.35	6.69	0.48	1.05	2.43	16.7	7.56	0.54	1.20	2.15	16.8	8.68	1.36	1.87	17.3
823	LINK REIT	47.00	20.67	2.93	0.86	4.35	4.2	22.10	3.13	0.87	4.07	4.0	23.69	0.88	3.80	3.8
83	SINO LAND CO	11.76	13.55	(4.12)	0.56	2.38	4.2	13.29	(4.04)	0.58	2.43	4.4	12.67	0.59	2.55	4.7
388	HKEX	206.80	25.57	2.95	8.40	3.51	33.9	28.63	3.30	8.94	3.13	31.9	30.20	9.33	2.97	33.9
1299	AIA GROUP LTD	48.40	16.26	1.33	1.90	1.37	12.2	18.00	1.47	2.09	1.24	12.2	20.48	2.31	1.09	11.6
2318	PING AN INS-H	44.25	10.37	1.38	1.45	1.47	14.7	11.45	1.52	1.61	1.33	15.0	11.99	1.84	1.27	16.9
2628	CHINA LIFE INS-H	26.75	11.44	1.04	1.54	3.07	14.4	13.29	1.20	1.76	2.64	14.0	14.11	1.97	2.49	14.7
1398	ICBC-H	4.73	4.64	1.08	0.66	7.06	14.9	4.93	1.15	0.73	6.64	15.6	5.04	0.81	6.49	16.9
3328	BANK OF COMMUN-H	5.57	4.94	1.73	0.56	6.14	11.7	5.19	1.81	0.60	5.85	12.1	5.23	0.66	5.80	13.2
3988	BANK OF CHINA-H	3.51	4.58	1.07	0.57	6.80	13.2	4.90	1.14	0.63	6.35	13.5	4.98	0.70	6.26	14.4
939	CCB-H	5.40	4.50	1.19	0.65	7.35	15.0	4.74	1.25	0.71	6.98	15.8	4.85	0.79	6.82	17.4
11	HANG SENG BK	142.50	13.14	(3.31)	1.74	5.39	13.5	14.35	(3.62)	1.82	4.93	13.0	12.12	1.90	5.84	15.9
23	BANK EAST ASIA	27.75	10.84	2.17	0.83	3.76	7.8	11.60	2.32	0.87	3.52	7.7	11.95	0.92	3.41	7.8
2388	BOC HONG KONG HO	24.15	8.11	0.83	1.13	5.94	14.5	9.00	0.92	1.22	5.35	14.2	9.79	1.33	4.92	14.2
5	HSBC HLDGS	62.55	9.46	3.29	0.80	7.51	8.6	10.20	3.55	0.82	6.96	8.2	10.01	0.84	7.09	8.3
762	CHINA UNICOM	9.51	13.06	2.08	0.74	3.00	5.8	14.98	2.38	0.77	2.62	5.2	14.76	0.79	2.66	5.5
941	CHINA MOBILE	90.10	11.56	1.63	1.41	3.72	12.6	12.53	1.77	1.51	3.43	12.5	13.25	1.63	3.24	12.8
700	TENCENT	154.40	23.43	0.82	6.27	0.48	30.2	29.98	1.05	8.13	0.37	30.9	38.74	10.81	0.29	32.4
992	LENOVO GROUP	8.42	8.11	0.09	2.15	5.43	28.4	9.45	0.11	2.48	4.66	28.8	27.86	3.00	1.58	10.7

(Cont' Exhibit 22)

Ticker	Company name	Price (HK$)	2017F P/E (x)	2017F PEG (x)	2017F P/B (x)	2017F Yield (%)	2017F ROAE (%)	2016F P/E (x)	2016F PEG (x)	2016F P/B (x)	2016F Yield (%)	2016F ROAE (%)	2015E P/E (x)	2015E P/B (x)	2015E Yield (%)	2015E ROAE (%)
144	CHINA MERCHANT	25.85	12.29	1.35	0.97	3.93	8.1	13.58	1.49	1.02	3.56	7.7	14.63	1.07	3.30	7.0
386	SINOPEC CORP-H	4.82	8.19	0.36	0.66	6.14	8.3	10.25	0.46	0.70	4.90	6.9	12.28	0.73	4.09	6.2
857	PETROCHINA CO-H	5.67	9.87	0.29	0.67	4.52	6.9	15.40	0.45	0.70	2.90	4.6	17.86	0.72	2.50	4.0
883	CNOOC LTD	8.92	8.54	0.24	0.78	3.94	9.4	13.61	0.39	0.83	2.47	6.2	15.63	0.86	2.15	5.5
135	KUNLUN ENERGY CO	6.90	10.44	0.72	0.90	2.76	8.8	12.04	0.84	0.95	2.39	8.1	13.66	1.00	2.11	7.5
1088	CHINA SHENHUA-H	12.66	7.87	1.21	0.62	4.83	8.1	8.98	1.38	0.65	4.24	7.4	8.92	0.68	4.26	7.7
293	CATHAY PAC AIR	13.34	7.26	0.81	0.81	6.19	11.5	7.97	0.89	0.86	5.64	11.2	8.62	0.93	5.22	11.3
66	MTR CORP	36.70	20.33	(16.62)	1.27	1.92	6.3	23.15	(18.92)	1.28	1.69	5.5	19.84	1.27	1.97	6.5
291	CHINA RES ENTERP	15.28	29.50	2.23	2.12	1.19	7.4	33.81	2.55	2.23	1.04	6.7	37.82	2.33	0.93	3.0
1928	SANDS CHINA	27.30	16.31	1.56	5.37	4.99	32.3	19.90	1.90	5.17	4.09	25.1	19.90	4.83	4.09	23.2
27	GALAXY ENTERTAIN	24.00	16.11	1.95	2.13	-	13.8	17.01	2.06	2.33	-	14.2	18.88	2.52	-	13.7
151	WANT WANT CHINA	6.10	15.14	2.92	3.47	3.40	24.5	15.74	3.04	3.98	3.27	26.6	16.75	4.42	3.07	28.2
2319	CHINA MENGNIU DA	12.40	12.17	0.91	1.40	1.90	12.0	14.08	1.06	1.54	1.64	11.4	15.63	1.68	1.48	11.3
322	TINGYI	11.46	17.00	1.30	2.18	2.94	13.4	18.48	1.41	2.37	2.70	13.3	21.75	2.57	2.30	12.2
1044	HENGAN INTL	78.35	18.35	1.64	4.11	3.42	23.5	20.44	1.83	4.54	3.07	23.3	22.69	5.00	2.76	23.0
1880	BELLE INTL	7.02	9.30	2.69	1.60	2.69	17.8	9.74	2.81	1.72	2.57	18.2	9.96	1.83	2.51	19.0
494	LI & FUNG	5.31	12.02	1.19	1.82	6.93	15.4	12.93	1.28	1.89	6.45	14.8	14.58	1.95	5.72	3.4
1	CKH HOLDGS	103.30	9.68	0.71	0.84	1.62	9.0	11.10	0.81	0.90	1.42	8.4	12.51	0.96	1.26	5.9
19	SWIRE PACIFIC-A	85.95	11.36	2.11	0.56	4.66	5.0	12.19	2.26	0.57	4.35	4.7	12.62	0.58	4.20	4.6
267	CITIC	14.04	6.35	2.80	0.63	2.12	10.5	7.29	3.21	0.70	1.84	10.0	6.64	0.76	2.02	12.0

Based on closing share prices on Dec 3, 2015
RMB0.8255/HK$1.00; HK$7.7501/US$1.00
PEG = P/E / est. 2015-17 EPS CAGR
Source: Bloomberg, ABCI Securities estimates

Exhibit 23: Market Valuation of H-share Index Stocks

Ticker	Company name	Price (HK$)	2017F P/E (x)	2017F PEG (x)	2017F P/B (x)	2017F Yield (%)	2017F ROAE (%)	2016F P/E (x)	2016F PEG (x)	2016F P/B (x)	2016F Yield (%)	2016F ROAE (%)	2015E P/E (x)	2015E P/B (x)	2015E Yield (%)	2015E ROAE (%)
1398	ICBC-H	4.73	4.64	1.08	0.65	7.06	14.8	4.93	1.15	0.72	6.64	15.5	5.04	0.81	6.49	16.9
939	CCB-H	5.40	4.50	1.19	0.65	7.35	15.1	4.74	1.25	0.72	6.98	15.9	4.85	0.80	6.82	17.4
1288	AGRICULTURAL-H	3.02	4.16	0.98	0.59	7.95	14.9	4.40	1.03	0.66	7.51	15.7	4.52	0.73	7.31	17.0
3988	BANK OF CHINA-H	3.51	4.58	1.07	0.56	6.80	12.7	4.90	1.14	0.61	6.35	13.0	4.98	0.67	6.26	14.0
3328	BANK OF COMMUN-H	5.57	4.94	1.73	0.56	6.14	11.8	5.19	1.81	0.61	5.85	12.2	5.23	0.66	5.80	13.2
3968	CHINA MERCH BK-H	18.28	5.38	0.56	0.84	5.61	16.5	6.02	0.63	0.95	5.01	16.7	6.46	1.07	4.67	17.6
998	CHINA CITIC BK-H	5.05	4.26	0.71	0.54	7.04	13.2	4.66	0.78	0.59	6.44	13.3	4.79	0.65	6.27	14.6
1988	CHINA MINSHENG-H	7.58	4.27	0.65	0.59	3.30	14.8	4.69	0.71	0.67	3.01	15.3	4.85	0.77	2.91	17.0
2628	CHINA LIFE INS-H	26.75	11.44	1.04	1.61	3.07	14.8	13.29	1.20	1.79	2.64	14.1	14.11	1.97	2.49	14.7
2318	PING AN INSURA-H	44.25	10.37	1.38	1.48	1.47	15.2	11.45	1.52	1.68	1.33	15.7	11.99	1.93	1.27	17.3
1339	PICC GROUP-H	4.09	8.32	(22.63)	1.01	0.37	12.9	8.77	(23.87)	1.14	0.35	13.9	8.25	1.31	0.37	17.2
2601	CHINA PACIFIC-H	33.45	13.64	2.49	1.66	3.01	12.7	15.10	2.75	1.80	2.71	12.4	15.17	1.94	2.70	13.4
1336	NEW CHINA LIFE-H	34.70	8.48	1.27	1.19	1.21	15.0	9.52	1.42	1.37	1.08	15.3	9.66	1.57	1.06	17.6
2328	PICC P&C-H	17.40	10.10	3.89	1.61	2.52	17.0	11.06	4.26	1.84	2.30	17.7	10.63	2.09	2.39	21.4
6030	CITIC SEC-H	18.44	9.20	3.00	1.22	3.27	13.9	9.81	3.20	1.34	3.07	14.4	9.77	1.49	3.08	16.2
6837	HAITONG SEC-H	13.58	8.58	24.78	1.13	3.64	13.9	9.46	27.31	1.25	3.30	13.8	8.64	1.37	3.62	16.9
6886	HUATAI SEC-H	19.06	9.65	1.64	1.38	3.11	15.1	11.56	1.97	1.54	2.60	14.3	10.81	1.78	-	18.0
1359	CHINA CINDA-H	2.88	4.19	0.27	0.64	7.13	16.3	4.83	0.31	0.73	6.18	16.0	5.61	0.82	5.32	15.5
1088	CHINA SHENHUA-H	12.66	7.87	1.21	0.62	4.83	8.0	8.98	1.38	0.65	4.24	7.4	8.92	0.68	4.26	7.7
857	PETROCHINA-H	5.67	9.87	0.29	0.67	4.52	7.0	15.40	0.45	0.71	2.90	4.7	17.86	0.73	2.50	4.1
386	SINOPEC CORP-H	4.82	8.19	0.36	0.70	6.14	8.8	10.25	0.46	0.74	4.90	7.4	12.28	0.77	4.09	6.4
2883	CHINA OILFIELD-H	7.68	9.27	0.35	0.59	3.29	6.5	12.19	0.46	0.62	2.50	5.2	14.85	0.64	2.05	4.3
902	HUANENG POWER-H	7.10	6.22	(1.21)	0.91	8.04	15.2	6.26	(1.22)	0.99	7.99	16.3	5.60	1.06	8.93	20.1
1816	CGN POWER-H	2.98	13.02	0.80	1.53	0.11	12.5	14.82	0.92	1.73	0.10	12.4	17.57	1.96	0.08	11.8
916	CHINA LONGYUAN-H	6.48	8.74	0.55	0.98	2.15	11.7	10.02	0.63	1.08	1.87	11.3	11.73	1.19	1.60	10.6
390	CHINA RAIL GR-H	6.54	8.72	1.05	0.91	1.86	10.9	9.41	1.14	1.00	1.72	11.1	10.22	1.09	1.58	11.2

(Cont' Exhibit 23)

Ticker	Company name	Price (HK$)	2017F P/E (x)	2017F PEG (x)	2017F P/B (x)	2017F Yield (%)	2017F ROAE (%)	2016F P/E (x)	2016F PEG (x)	2016F P/B (x)	2016F Yield (%)	2016F ROAE (%)	2015E P/E (x)	2015E P/B (x)	2015E Yield (%)	2015E ROAE (%)
1800	CHINA COM CONS-H	8.90	6.37	0.54	0.75	3.13	12.4	7.15	0.61	0.83	2.79	12.3	7.96	0.92	2.51	12.2
1766	CRRC CORP -H	10.54	15.16	1.08	1.95	-	13.7	16.80	1.19	2.23	-	14.3	19.73	2.58	-	14.0
1211	BYD CO LTD-H	41.80	29.32	1.43	2.62	-	9.3	36.32	1.77	2.87	-	8.2	42.60	3.12	-	7.6
489	DONGFENG MOTOR-H	10.54	5.44	0.80	0.70	2.47	13.5	5.69	0.84	0.78	2.36	14.6	6.20	0.89	2.16	15.3
2333	GREAT WALL MOT-H	9.65	7.20	0.90	1.35	4.21	20.0	7.47	0.93	1.55	4.06	22.5	8.40	1.83	3.61	23.7
2202	CHINA VANKE-H	21.30	8.23	0.55	1.48	4.25	19.1	9.26	0.62	1.68	3.77	19.4	10.86	1.93	3.22	18.9
3699	WANDA COMM-H	47.65	6.84	0.33	0.85	2.13	13.1	8.04	0.39	0.95	1.82	12.5	9.99	1.06	1.46	11.1
914	ANHUI CONCH-H	22.20	10.33	0.96	1.17	3.04	11.8	11.30	1.05	1.27	2.78	11.7	12.68	1.39	2.48	11.3
3323	CHINA NATL BDG-H	4.18	5.85	0.40	0.39	2.56	6.9	6.47	0.44	0.42	2.32	6.6	7.70	0.44	1.95	5.9
1099	SINOPHARM-H	33.85	14.97	0.84	2.06	1.87	14.5	17.61	0.99	2.30	1.59	13.8	20.74	2.56	1.35	12.9
168	TSINGTAO BREW-H	33.95	19.22	3.13	1.97	1.59	10.6	20.58	3.35	2.12	1.48	10.7	21.66	2.29	1.41	11.0
728	CHINA TELECOM-H	3.72	10.52	1.07	0.75	3.29	7.3	11.90	1.21	0.78	2.91	6.7	12.69	0.82	2.73	6.6
753	AIR CHINA LTD-H	6.42	6.35	0.68	0.87	2.65	14.5	6.93	0.75	0.98	2.43	15.0	7.58	1.11	2.22	15.7

Based on closing share prices on Dec 3, 2015

RMB0.8255/HK$1.00

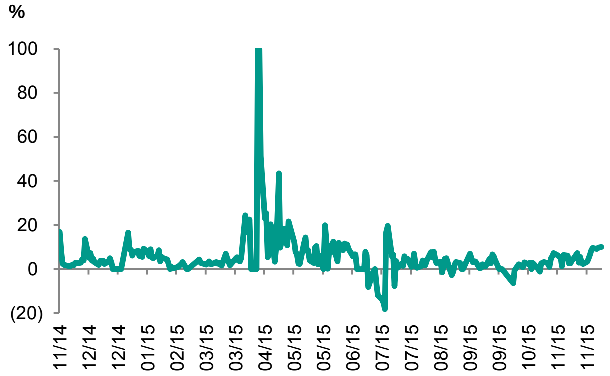
PEG = P/E / est. 2015-17 EPS CAGR

Source: Bloomberg, ABCI Securities estimates

Shanghai-Hong Kong Stock Connect – Investment Strategy

The launch of Shanghai-Hong Kong Stock Connect in 2014 signaled 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 Exchange (HKEx), and mainland investors to access Hong Kong shares through the Shanghai Stock Exchanges (SSE). Up to Dec 4, 2015, investors used up around 40.8% of the northbound investment quota of RMB 300bn and 38.5% of the southbound quota of RMB 250bn. Behaviors of China and Hong Kong investors indicate cautiousness on turbulence in the global capital market. We believe it will take time for the investing community to familiarize itself with the 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. We believe, the scheme will expand to the Shenzhen Stock Exchange and cover other asset classes in 1Q16.

Exhibit 1: SH-HK Connect (Southbound) – percentage of quota used



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

Exhibit 2: SH-HK Connect (Northbound) – percentage of quota used

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

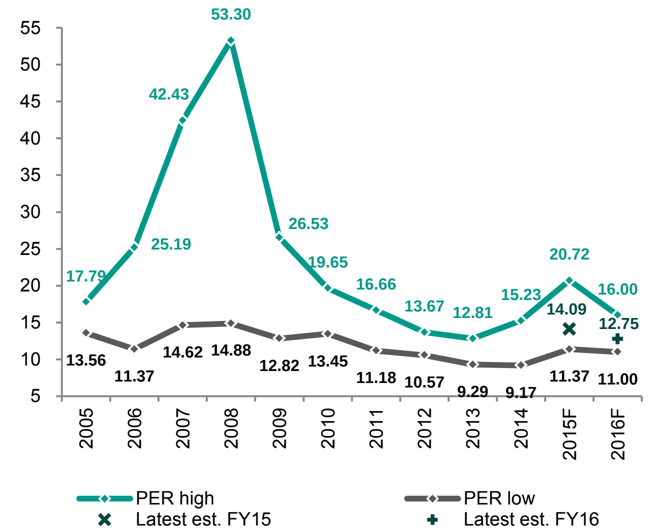
2016 Outlook for Shanghai Composite Index and CSI 300 Index

Emergence of upside after market correction

Following a sharp decline of 30% of Shanghai Composite Index (SHCOM) from its closing high on June 12, 2015 and RMB depreciation of more than 3% since the adjustment of daily fixing rate on Aug 11, 2015, China's stock market has been volatile for the past few months. Looking forward, China will launch more stimulus to revive economic momentum and accommodative economic policies will continue to support higher valuations of the Chinese stocks. As China works through its reform agenda, opportunities will emerge in new areas. For 2016, we are optimistic on (1) the military sector, which should also see strong growth as military expenditures surge; (2) the consumer sector, as surging wage rise will drive consumption; (3) the infrastructure sector, as the "New Silk Road" vision will unleash the potential of large-scale investments in the infrastructure and railway; (4) the smart manufacturing sector, as the "Manufacturing 2025" initiative will benefit high-tech manufacturing.

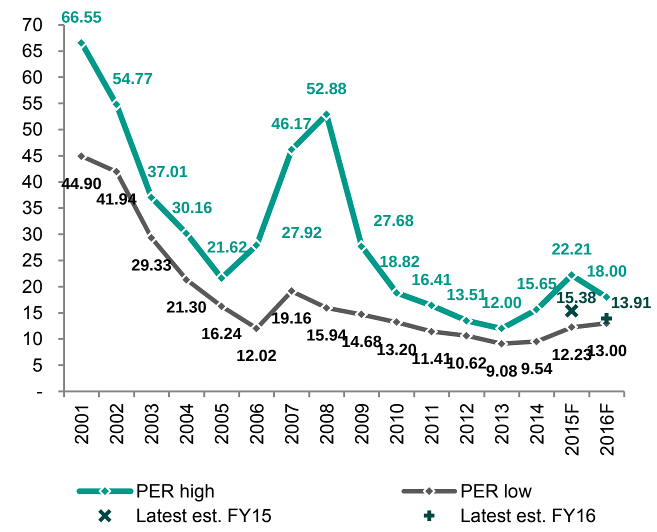
We believe risk premium in the stock market has declined. Equity valuation has risen substantially from mid-2014 to mid-2015. Currently, the risk premium is at 1 S.D. below the seven-year average, and therefore space for further decline is limited in 2016. We forecast the P/E band of SHCOMP would rise to 13x-18x in 2016F from 9.5x-15.6x in 2014 and 12.2x-22.1x in 2015, representing a trading range of 3,372-4,670. Also, we forecast the P/E band of Shenzhen Component Index would rise to 15-25x in 2016F from 10.9-17.3x in 2014 and 21.0-41.3x in 2015, representing a trading range of 8,304-13,840. Meanwhile, we forecast the P/E band of CSI 300 Index would increase to 11.0-16.0x in 2016F from 9.1-15.2x in 2014 and 11.3-20.6x in 2015, representing a trading range of 3,169-4,609. We believe high market liquidity will be the main driver of stock market rebound in 2016.

Exhibit 3: CSI300 Index P/E band (Index: 3,749)



Source(s): ABCI Securities estimates

Exhibit 4: Shanghai Composite Index P/E band (Index: 3,585)



Source(s): ABCI Securities estimates

Northbound Investment Strategy

Northbound investment under the connect scheme implies global investors can invest in the selected A shares through the Shanghai-Hong Kong stock exchange platform. We believe most northbound investments are conducted by institutional investors that have previously participated in the A-share market via the QFII and RQFII programs. Enthusiasm among the retail investors in Hong Kong is also increasing as familiarity with the operation and investment norm of the A-share market increases. Although the northbound trading volume is still low at present, we are positive on the performance of A-share market as we believe the 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, we observe that the appetite of offshore investors for A-shares mainly gears toward: (1) military sector; (2) consumer sector; (3) infrastructure Sector; (4) smart manufacturing sector. Our selected picks for northbound investors are listed below. :

Military sector

Stock name	Stock code	2016F P/E	2017F P/E	2016F P/B	2017F P/B
Beifang Chuangye Co	600967 SH	50.91	43.28	-	-
China Shipbuilding Industry Co Ltd	601989 SH	85.32	52.32	2.77	2.61
China Avic Electronics Co Ltd	600372 SH	62.92	48.61	7.01	6.26
North Navigation Control Technology	600435 SH	722.25	577.80	10.70	10.66
China Spacesat Co Ltd	600118 SH	114.02	96.46	10.60	9.72

Source(s): Bloomberg, ABCI Securities

Consumer Sector

Stock name	Stock code	2016F P/E	2017F P/E	2016F P/B	2017F P/B
Kweichow Moutai Co Ltd	**600519 SH**	16.07	14.63	4.05	3.42
Tsingtao Brewer	**600600 SH**	24.16	23.18	2.51	2.32
Inner Mongolia Yili Industrial Group	**600887 SH**	19.01	16.05	4.20	3.64
Yonghui Superstores Co Ltd	**601933 SH**	40.37	32.65	3.43	2.97

Source(s): Bloomberg, ABCI Securities

Infrastructure Sector

Stock name	Stock code	2016F P/E	2017F P/E	2016F P/B	2017F P/B
Shanghai Int'l Airport	**600009 SH**	22.95	19.37	2.85	2.56
Shanghai Int'l Port	**600018 SH**	22.94	21.00	2.65	2.49

Source(s): Bloomberg, ABCI Securities

Smart Manufacturing sector

Stock name	Stock code	2016F P/E	2017F P/E	2016F P/B	2017F P/B
Shanghai Mechanical and Electrical Industry Co Ltd	**600835 SH**	17.55	17.53	3.78	3.34
Changyuan Group	**600525 SH**	35.84	27.38	5.15	4.32
NeuSoft	**600718 SH**	19.01	16.05	4.20	3.64

Source(s): Bloomberg, ABCI Securities

Improving on stabilized economy

- Policy risk of the sector is reducing upon completion of interest rate liberalization and increased clarity of various operation-related measures
- Although asset quality is stabilizing, large provision should persist along with robust loan growth in coming quarters
- Deposit competition remains moderate, hinting to a manageable NIM outlook in 2016
- Mixed operation will accelerate; fee competition is expected
- Maintain **OVERWEIGHT** on China banks sector

China Banks Sector

OVERWEIGHT

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Lower policy risk. Interest rate liberalization is considered complete after the removal of deposit rate cap in Oct 2015; meanwhile, developments in operation-related policies are becoming clear. In our opinion, policy risk is reducing. Hence, we forecast valuation of the China banks sector to normalize in 2016 upon a stabilizing macro-economic outlook. Maintain **OVERWEIGHT** on the sectors undemanding valuation and sustainable dividend yield.

Slow earnings growth on increased provisions. We believe asset quality has stabilized with a mild increase in NPLs. As demonstrated in 3Q15, NPL ratios in most banks only inched up 1-10bps QoQ, and asset quality in coastal areas have also bottomed out. Nevertheless, large provisions will persist in the next few quarters to sustain the provisioning ratio and provision coverage ratio given the robust loan growth (9M15: 6.5%-12.8% YTD). Hence, earnings growth will be suppressed in 2015/16.

NIM squeeze is manageable. In 9M15, NIM narrowed by 11bps YoY among banks. Interest rate liberalization and rate cut cycle have not stiffened deposit competition, as shown by the decent deposit growth in 9M15 (4.9%-11.5% YTD) and a stable deposit rate at 1.3-1.5x the benchmark rates. We expect the sector's NIM to contract by 15-25bps in 2016F.

Competition landscape to change on mixed operation. We believe the development of mixed operation will accelerate in 2016; banks' income sources will expand and competition in fee income will increase. Small banks will turn more aggressive, but we believe the solid customer base in the big banks will render them more competitive.

ICBC (1398 Hong Kong, BUY). We continue to favor big banks. ICBC enjoyed a decent net fee growth in 9M15, indicating that the bank has taken proactive measures to expand business. Its current valuation at 0.69x FY16F P/B with a FY16F dividend yield of 7.40% is attractive.

CCB (939 HK, BUY). CCB's prudent management has always been its strongest suit. Its ability to balance between risk and growth is well demonstrated in 9M15. Its undemanding valuation at 0.69x FY16F P/B with a 7.18% FY16F dividend yield represents a good entry point.

Risk factors: 1) Increasing competition from non-bank financial institutions; 2) Sharp asset quality deterioration and weak loan demand; 3) New regulations affecting banks' operation and profitability.

Key Data

Avg.16F P/E (x)	4.32
Avg.16F P/B (x)	0.63
Avg.16F Dividend Yield (%)	6.76

Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

	Absolute	Relative*
1-mth	(5.25)	(1.95)
3-mth	(1.74)	(4.53)
6-mth	(25.24)	(0.59)

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

1-Year Sector performance (%)

Source(s): Bloomberg, ABCI Securities

Exhibit 1: 3Q15 key indicators of Chinese banks

(RMB mn)	ICBC	CCB	ABC	BOC	BoCom	MSB	CMB	CITICB	CEB	Big 5 avg	JSB avg
NII											
3Q14	125,327	111,945	108,355	82,100	35,169	23,805	29,779	24,434	15,631		
3Q15	127,858	116,189	109,247	82,889	36,916	23,495	35,055	27,002	17,553		
YoY (%)	**2.0**	**3.8**	**0.8**	**1.0**	**5.0**	**(1.3)**	**17.7**	**10.5**	**12.3**	**2.5**	**9.8**
9M14	362,934	323,237	317,793	238,775	102,380	67,405	85,949	70,048	43,469		
9M15	379,945	340,808	328,740	246,280	107,975	70,489	101,159	76,746	49,658		
YoY (%)	**4.7**	**5.4**	**3.4**	**3.1**	**5.5**	**4.6**	**17.7**	**9.6**	**14.2**	**4.4**	**11.5**
Net fee											
3Q14	27,657	23,621	18,072	19,947	7,283	9,372	9,174	6,028	4,811		
3Q15	34,063	25,041	18,969	21,440	8,042	12,807	13,880	8,588	6,703		
YoY (%)	**23.2**	**6.0**	**5.0**	**7.5**	**10.4**	**36.7**	**51.3**	**42.5**	**39.3**	**10.4**	**42.4**
9M14	100,885	83,801	65,920	72,078	22,984	27,810	30,564	18,835	13,443		
9M15	111,183	88,686	66,612	71,484	27,428	37,952	44,977	26,068	20,261		
YoY (%)	**10.2**	**5.8**	**1.0**	**(0.8)**	**19.3**	**36.5**	**47.2**	**38.4**	**50.7**	**7.1**	**43.2**
Topline											
3Q14	152,688	138,688	127,841	111,278	44,902	34,787	40,978	30,507	20,503		
3Q15	167,096	144,482	133,835	117,062	49,875	39,268	52,242	37,667	24,569		
YoY (%)	**9.4**	**4.2**	**4.7**	**5.2**	**11.1**	**12.9**	**27.5**	**23.5**	**19.8**	**6.9**	**20.9**
9M14	469,541	415,415	395,750	346,150	135,775	99,916	125,395	92,608	58,063		
9M15	503,833	442,299	410,144	355,940	147,021	116,170	156,489	107,624	70,156		
YoY (%)	**7.3**	**6.5**	**3.6**	**2.8**	**8.3**	**16.3**	**24.8**	**16.2**	**20.8**	**5.7**	**19.5**
Impairment											
3Q14	8,238	16,302	16,082	11,296	6,341	5,961	5,678	6,157	2,832		
3Q15	19,301	22,874	18,044	16,317	8,250	9,833	14,781	11,774	6,163		
YoY (%)	**134.3**	**40.3**	**12.2**	**44.4**	**30.1**	**65.0**	**160.3**	**91.2**	**117.6**	**52.3**	**108.5**
9M14	32,226	39,424	45,021	39,078	16,500	13,179	21,998	17,774	5,960		
9M15	61,253	64,123	57,365	44,893	19,704	24,844	43,952	28,465	14,550		
YoY (%)	**90.1**	**62.6**	**27.4**	**14.9**	**19.4**	**88.5**	**99.8**	**60.1**	**144.1**	**42.9**	**98.1**
Net profit											
3Q14	72,364	59,636	48,407	41,409	14,749	11,208	15,345	10,246	7,477		
3Q15	72,740	59,662	48,895	40,799	14,716	11,599	15,524	10,340	7,634		
YoY (%)	**0.5**	**0.0**	**1.0**	**(1.5)**	**(0.2)**	**3.5**	**1.2**	**0.9**	**2.1**	**(0.0)**	**1.9**
9M14	220,464	190,298	152,439	131,133	51,522	36,778	45,804	32,280	23,322		
9M15	221,761	191,557	153,210	131,545	52,040	38,377	48,500	32,926	23,875		
YoY (%)	**0.6**	**0.7**	**0.5**	**0.3**	**1.0**	**4.3**	**5.9**	**2.0**	**2.4**	**0.6**	**3.7**
Total loan											
Dec-14	10,768,750	9,222,897	7,739,996	8,294,744	3,354,787	1,774,159	2,448,754	2,136,332	1,271,430		
Sep-15	11,610,463	10,091,195	8,482,659	8,837,177	3,639,712	1,932,309	2,633,672	2,317,329	1,433,869		
YTD (%)	**7.8**	**9.4**	**9.6**	**6.5**	**8.5**	**8.9**	**7.6**	**8.5**	**12.8**	**8.4**	**9.4**
Deposits											
Dec-14	15,556,601	12,899,153	12,533,397	10,885,223	4,029,668	2,433,810	3,304,438	2,849,574	1,785,337		
Sep-15	16,521,828	13,827,713	13,554,404	11,548,697	4,493,337	2,708,015	3,467,658	3,148,587	1,958,935		
YTD (%)	**6.2**	**7.2**	**8.1**	**6.1**	**11.5**	**11.3**	**4.9**	**10.5**	**9.7**	**7.8**	**9.1**
NIM											
9M14	na	2.80	na	2.26	2.40	2.61	2.61	2.37	na		
9M15	na	2.64	na	2.14	2.24	2.29	2.75	2.33	na		
YoY (%)	**na**	**(0.16)**	**na**	**(0.12)**	**(0.16)**	**(0.32)**	**0.14**	**(0.04)**	**na**	**(0.15)**	**(0.07)**
NPL ratio											
Jun-15	1.40	1.42	1.83	1.41	1.35	1.36	1.50	1.32	1.42		
Sep-15	1.44	1.45	2.02	1.43	1.42	1.45	1.60	1.42	1.43		
QoQ (%)	**0.04**	**0.03**	**0.19**	**0.02**	**0.07**	**0.09**	**0.10**	**0.10**	**0.01**	**0.07**	**0.08**

Source(s): Company reports, ABCI Securities

Sector Valuation Summary (Data as of Dec 3, 2015)

Ticker	Company	Rating	TP (HK$)	Upside (%)	FY15F P/E(x)	FY16F P/E (x)	FY15F P/B (x)	FY16F P/B (x)	FY15F Yield (%)	FY16F Yield (%)
1398 HK	ICBC	BUY	7.70	62.79	4.67	4.30	0.78	0.69	7.14	7.40
939 HK	CCB	BUY	9.00	66.67	4.70	4.36	0.77	0.69	6.71	7.18
1288 HK	ABC	BUY	5.38	78.15	4.09	3.78	0.67	0.60	7.86	8.28
3988 HK	BOC	BUY	6.10	73.79	4.46	4.01	0.64	0.58	7.48	8.19
3328 HK	BoCom	BUY	9.53	71.10	5.24	4.74	0.64	0.58	5.83	6.28
3968 HK	CMB	BUY	27.20	48.80	5.92	5.26	1.02	0.89	5.06	5.68
1988 HK	MSB	BUY	12.68	67.28	4.36	4.13	0.74	0.64	3.46	3.63
998 HK	CITICB	HOLD	7.25	43.56	4.39	4.04	0.65	0.58	6.93	7.43
6818 HK	CEB	BUY	5.78	57.49	4.66	4.45	0.66	0.58	6.47	6.81
3698 HK	HB	BUY	4.69	37.54	4.96	4.62	0.71	0.62	5.87	6.60
6138 HK	HRB	BUY	3.60	62.90	4.53	4.02	0.58	0.52	6.79	7.35
1963 HK	BoCQ	BUY	9.28	61.11	4.27	4.15	0.64	0.54	5.43	6.29

Source(s): Bloomberg, ABCI Securities estimates

Stay with the market leaders

- Proportion of funds financed by the capital market will increase in social aggregate finance
- Development of multi-tiered capital market, amendment of securities law, and development of financial leveraged products in 2016 will favor large-sized and nationwide securities firms
- Margin financing and stock lending (MFSL) is a low-risk and lucrative business with further growth potential
- Proprietary trading revenue is sensitive to regulatory risk and may present earnings shocks in 2016

China Brokerage Sector

OVERWEIGHT

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Total stock market cap in China will increase to 62% of nominal GDP in 2015 from 59% in 2014 (vs. 146%/137%/90% in US/UK/Japan in 2014). The underdeveloped stock market in China has driven up the financial leverage of the economy. Systematic risk in banking industry mounts as economic structure undergoes transformation. To tackle the risk and provide sufficient financial resources for economic growth, the government is accelerating development in equity and bond securities market, in addition to widening the liquidity inflow channels for overseas investors to participate in the domestic capital market.

Amendments of securities law, development of multi-tiered capital markets, and innovation of financial products will fuel growth in capital market. Nationwide securities firms and asset management companies are set to benefit from their increasingly important roles in financial resource allocation. Market share of the banking sector in overall society aggregate finance will be eroded by non-bank financial sector. For 9M15, bond and equity finance accounted for 13.2% of total aggregate finance in social aggregate finance. According to our calculation, a 1% increase in market share will translate into a net increase of RMB 1,796 bn in bond and equity market.

Margin financing and stock lending (MSFL) remains a low-risk and lucrative business in 2016. MSFL takes up 10-15% daily stock market transactions. Outstanding loan balance of MSFL business accounts for less than 4% of total free-float A-share market cap and is covered by a collateral value of over 250% on average. Average O/S balance per borrower is ~RMB1 mn. The number of borrowers accounts for less than 2% of total A-share investors or 11% of active A-share investors. Net interest income accounts for 11% of total revenue income of the industry.

Securities industry is shifting to a lending or advisory-based model. The decline of commission rate in transaction-based brokerage business is inevitable. MSFL is a lending business by nature and its growth is constrained by the financial strength of securities firms. Securities players that have shifted to an advisory-based business model will have a first-mover advantage.

Proprietary trading will be a swing factor in profitability. In 3Q15, securities firms are required to support the stock market with internal capital amid the A-share market crash. The investment amount was as high as 15% of the company's net capital. We believe these in-house investments may catalyze net profit growth in 2016.

Key Data

Avg.16F P/E (x)	9.43
Avg.16F P/B (x)	1.16
Avg.16F Dividend Yield (%)	3.44

Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

	Absolute	Relative*
3-mth	27.9	20.8
6-mth	(27.7)	(13.7)
12-mth	(21.5)	(17.1)

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

1-Year Sector performance (%)

Source(s): Bloomberg, ABCI Securities

Industry revenue composition (%)

	2014	9M15
Brokerage	40.3%	50.1%
Proprietary trading	27.3%	23.5%
Interest income	17.1%	11.2%
Underwriting & sponsors	9.2%	5.5%
Assets mgt	4.8%	4.1%
Financial advisory	2.7%	1.7%
Investment consulting	0.9%	0.7%
Others	-2.3%	3.2%
Total	100.0%	100.0%

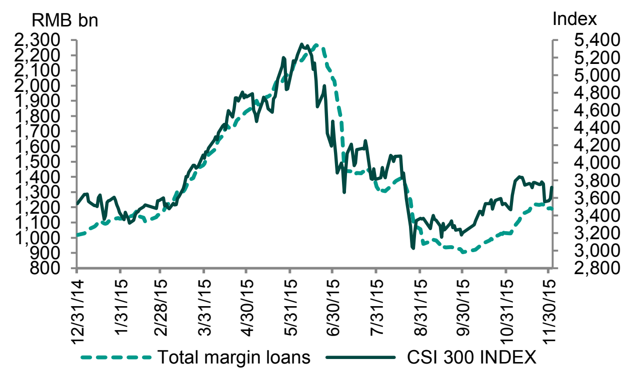
Source(s): SAC

T+1 cash/stock settlement practice constrains growth of brokerage transactions. In 2007-2008 and 1H15, the stock market crashed when the market cap became larger than the money supply, M1. Based on the current settlement practice, M1 will be the overall financial constraint of the brokerage industry. Assuming an 8-10%YoY increase in M1, CSI 300 Index may reach as high as 4,300 in 2016F.

More leveraged products to be launched in 2016-17. Rapid increase in outstanding loan balance of MFSL business hints that a sizeable group of wealthy and risk-tolerant investors are desperately looking for leveraged financial products (e.g. derivative securities).

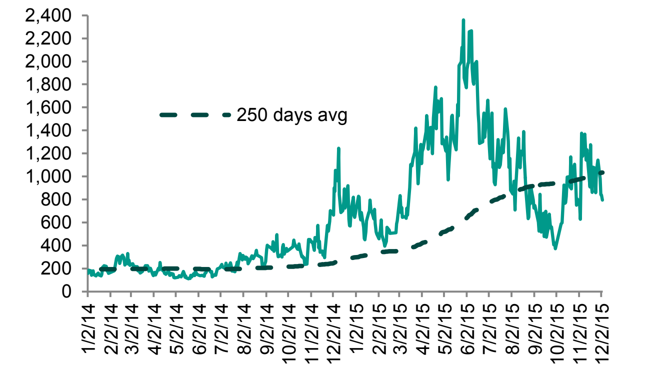
Risk factors: 1) Market liberalization risk; 2) Regulatory risk; 3) Credit and investment risks; 4) Corporate governance issues; 5) Business independence issue; 6) High sector beta (vs. HSI) ~1.80.

Exhibit 1: Margin loans in SSEx & SZEx vs. CSI 300 Index



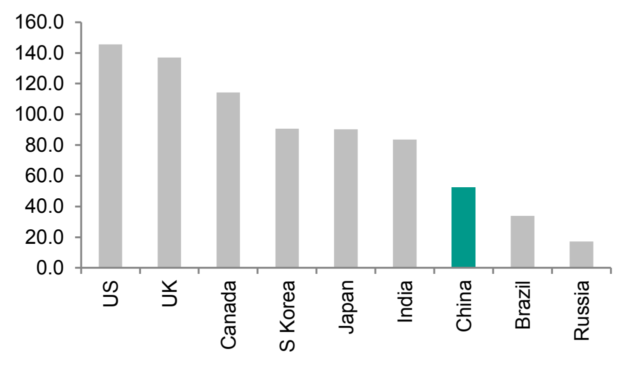
Source(s): Bloomberg, ABCI Securities

Exhibit 2: Avg daily stock market turnover (RMB bn)



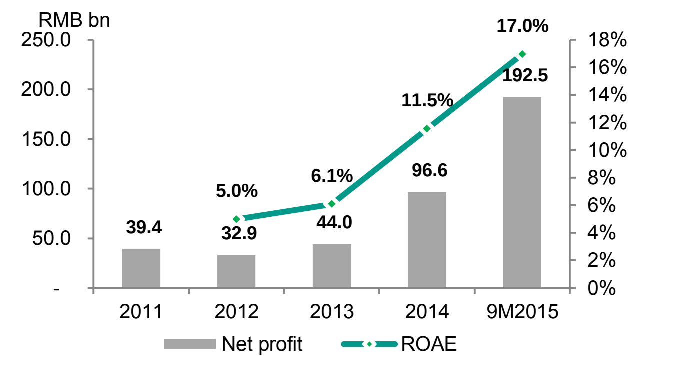
Source(s): Bloomberg, ABCI Securities

Exhibit 3: Current stock market cap/2014 GDP (%)



Source(s): Bloomberg

Exhibit 4: Profitability of China's securities industry



Source(s): Securities Association of China, ABCI Securities

Sector Valuation Summary (Data as of Dec 3, 2015)

Ticker	Company	Price (HK$)	FY15F PER	FY15F P/B	FY15F Yield (%)	FY15F ROAE (%)	FY16F PER	FY16F P/B	FY16F Yield (%)	FY16F ROAE (%)
6837	Haitong Sec	13.58	8.64	1.24	3.15	14.44	9.46	1.13	3.01	12.47
6030	CITIC Sec	18.44	9.77	1.34	2.82	13.90	9.81	1.23	2.90	13.04
6886	Huatai Sec	19.06	10.81	1.42	2.57	13.32	11.56	1.30	2.40	11.77
6881	Galaxy Sec	7.15	6.50	1.04	4.63	16.19	7.97	0.93	3.91	12.32
3908	CICC	11.36	11.28	1.36	-	16.32	14.64	1.24	1.84	8.86
1375	CC Sec	4.40	6.72	1.48	7.63	23.25	5.78	1.30	8.18	23.97
1456	Guolian	4.99	6.23	1.02	3.16	19.56	4.32	0.85	3.89	21.43
1476	Hengtou	3.72	4.73	1.08	-	24.71	8.70	0.96	2.30	11.66

@HK$0.8253/RMB; Source(s): Bloomberg, ABCI Securities estimates

Thorny road ahead

- Liquid milk and milk formula segments would see lower or negative growth in 2016; two-child policy will not have major impacts on the dairy industry in 2016
- The El Nino phenomenon and proactive reduction of milk production may reduce the growth of global supply of milk powder, which could be positive to domestic raw milk price
- Dairy industry players may boost inorganic growth through M&A; stock prices would be event-driven

China Dairy Sector

NEUTRAL

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Liquid milk segment to see lower growth. The liquid milk segment may experience lower growth as consumption in China decelerates and preference for fresh milk products or overseas imported products increases. Low price pressure and weakening downstream demand do not bode well for raw milk suppliers.

Milk formula segment to underperform. Danone's divestment in Dumex, consolidation of Mengniu's milk powder business, and Biostime's diversifying into non-dairy business by acquiring Swisse Wellness by Biostime (1112 HK) reflect a rather languid sentiment in the milk formula segment. We believe the downturn of domestic milk formula segment has been driven by consumers' longstanding distrust against domestic products and increased access to foreign products via e-commerce sites.

Muted impact of the new population policy on dairy sector. The government announced the two-child policy in late 2015. We believe it will take time for the policy to be implemented nationwide due to various administrative and social barriers. Therefore, we believe the immediate impact of the policy will be limited on the sector in 2016.

Supply-side pressure may elevate international milk price. The El Niño in 2015 has resulted in higher temperature and we believe the climatic effect would extend beyond 1Q16. We expect that the growth of global milk production would decelerate on warmer climate and proactive steps to curb production in 2016. This could help elevate the international milk powder price and lessen the downward pressure on raw milk price in China.

Expansion may be driven by inorganic growth. The less-than-sanguine industry and economic environment ahead suggest limited opportunities for industry players. We believe the big players would step up their acquisition efforts to diversify their product portfolio and strengthen leadership in the industry. Specifically, national dairy companies may acquire regional ones to increase their market share in pasteurized milk and chilled yogurt product. Some industry players may diversify into non-dairy businesses. Also, the latest policy to restrict the number of milk formulas in the country may trigger a wave of consolidation in the segment, favoring the large milk powder manufacturers.

Risk factors: 1) Slowdown of macroeconomic growth in China; 2) Policy risk; 3) Product safety risk; 4) Mismatch in supply and demand; 5) Lower domestic brand loyalty due to easier access to foreign products.

Key Data

Avg.16F P/E (x)	18.35
Avg.16F P/B (x)	1.69
Avg.16F Dividend Yield (%)	1.17

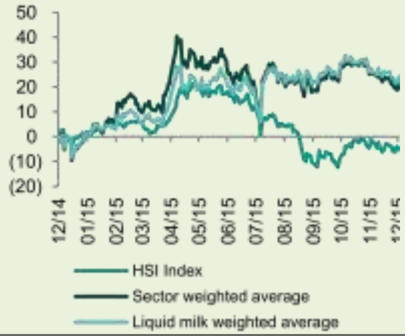
Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

	Absolute	Relative*
1-mth	(10.50)	(7.33)
3-mth	(7.02)	0.92
6-mth	(10.01)	(4.11)

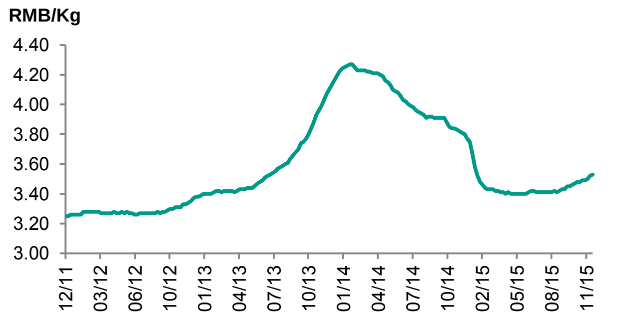
* Relative to HSI
Source(s): Bloomberg, ABCI Securities

1-Year Sector performance (%)



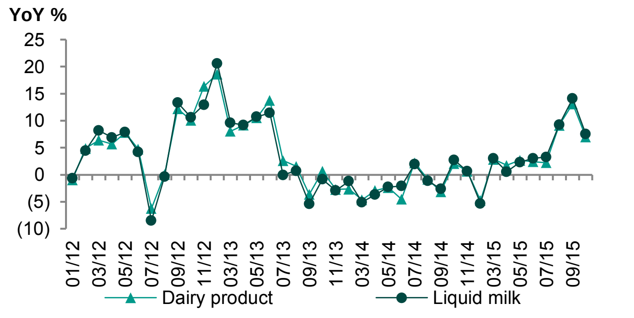
Source(s): Bloomberg, ABCI Securities

Exhibit 1: Raw milk price in China



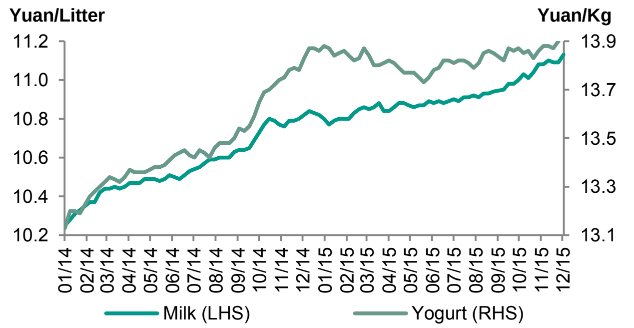
Source(s): Wind, ABCI Securities

Exhibit 2: Production volume growth of China's dairy product



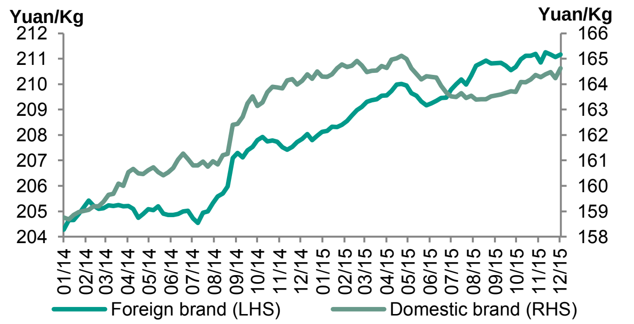
Source(s): Wind, ABCI Securities

Exhibit 3: Milk and yogurt retail prices in China



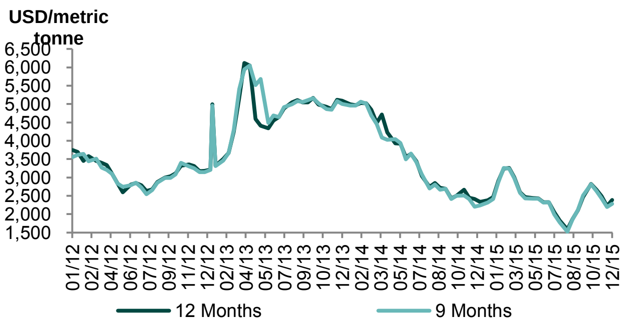
Source(s): Wind, ABCI Securities

Exhibit 4: Infant milk formula price in China



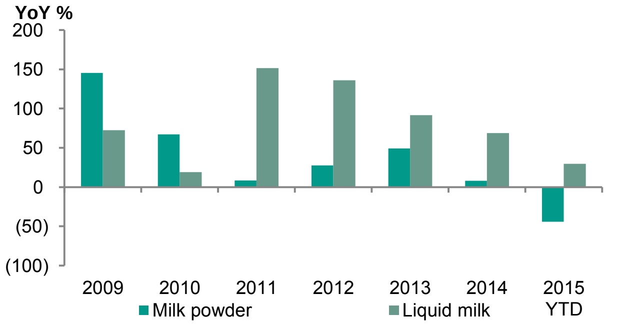
Source(s): Wind, ABCI Securities

Exhibit 5: New Zealand whole milk powder price



Source(s): Bloomberg, ABCI Securities

Exhibit 6: Import volume of dairy product in China



Source(s): Wind, ABCI Securities

Exhibit 7: Sector Valuation Summary (Data as of Dec 3, 2015)

Ticker	Company	TP (HK$)	Price return (%)		P/E (x)		P/B (x)		ROAE		Rev growth (YoY %)		NPM (%)	
			3 Mth	YTD	FY16F	FY17F	FY16F	FY17F	FY16F	FY17F	FY14	1H15	FY14	1H15
2319 HK	Mengniu Dairy	15.14	(4.21)	(19.63)	16.15	12.50	2.19	1.92	11.80	13.88	15.44	(1.05)	4.70	5.24
6863 HK	Huishan Dairy	-	0.35	113.33	36.19	25.97	2.44	2.27	7.49	9.31	11.13	7.14	23.10	17.87
1117 HK	Modern Dairy	2.59	(1.84)	(3.62)	12.16	10.81	1.81	2.03	9.79	9.87	52.82	(5.70)	14.63	19.57
1431 HK	Yuanshengtai	-	7.27	(22.37)	4.45	4.08	0.40	0.37	9.32	10.40	32.03	(2.57)	44.80	2.00
1432 HK	Shengmu	1.72	(4.55)	(29.71)	9.72	7.35	2.01	1.65	15.72	17.33	86.45	52.78	33.35	24.11
1112 HK	Biostime	12.91	0.76	(16.94)	11.54	9.15	1.85	1.58	17.10	18.59	3.73	(10.33)	17.05	10.44
1230 HK	Yashili	-	(8.25)	(13.70)	38.23	25.70	1.15	1.13	3.28	4.46	(27.6)	(24.85)	13.50	6.50

Source(s): Bloomberg, ABCI Securities estimates

Market leaders as winners

- Market leaders in health insurance, agricultural insurance and Internet-based insurance will see strong growth in 2016-17
- New solvency margin system to be implemented in 2016 will lead to higher market concentration, favoring the large players
- Liberalization of life insurance premium rate will stimulate demand
- Rapid expansion of the corporate bond market will increase yield on fixed income investments

China Insurance Sector

OVERWEIGHT

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Increase in penetration rate and density to drive premium growth. We estimate the penetration rate (Premium/GDP) increased to 3.9% in 9M15 from 3.18%/2.93% in 2014/2013. The government aims to achieve a penetration rate of 5% and an insurance density of RMB 3.5K per capita by 2020, implying that original premium income per capita and nominal GDP would grow by a CAGR of 15.4% and 7.0% in 2014-20.

Implementation of C-ROSS in 2016 will lead to a higher market concentration. The C-ROSS (a new solvency margin system similar to banks' CAR) will raise minimal capital requirement of insurers and lower the industry's systematic risk. Leading reinsurers such as China Re (1508 HK) will benefit from insurers ceding their insurance contracts in order to reserve capitals. We believe the industry will have a new round of cash calls or IPOs in 2016-17. M&A activities of small-sized insurers will increase. In 2015, Bank of China (3988) acquired a 51% stake in BOC-Samsung Life while Evergrande (3333) bought a 50% stake in Great Eastern Life.

Liberalization of life insurance premium rates will stimulate demand. Life insurance premium income grew 21.2% YoY in 10M15 after recording a 15.7%YoY growth in 2014. However, life insurers may need to increase the weighting of risk assets among investment assets to enhance returns and compensate for the higher discount rates for insurance contracts. In view of the lower deposit rate in 2016, we anticipate life insurers to increase their holdings of high-yield corporate bonds.

Surging health insurance to benefit market leaders. Health insurance premium soared 48% YoY in 10M15 after surging by 41% YoY in 2014. Rising revenue in health insurance should benefit market leaders such as China Life (2628 HK) and Ping An (2318 HK), whose market shares are 18% and 11% in the segment.

Agricultural insurance (Agr Ins) is growing rapidly in P&C insurance industry. The slowdown of auto sales to mid-single-digit growth caps the premium increase of P&C insurers that rely heavily on auto insurance. In contrast, premium growth of Agr Ins accelerated from 6.3%YoY in 2014 to 15% YoY in 9M15. We expect Agr Ins to be a new growth driver for P&C insurers in 2016. The market leader, PICC P&C (2328 HK) that has a 54% market share in Agr Ins, is set to benefit.

Key Data

Avg.16F P/E (x)	11.43
Avg.16F P/B (x)	1.46
Avg.16F Dividend Yield (%)	1.44

Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

	Absolute	Relative*
3-mth	15.5	8.4
6-mth	(21.5)	(2.5)
12-mth	20.0	24.3

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

1-Year Sector performance (%)

Source(s): Bloomberg, ABCI Securities

Solvency margin (%)

At end 6/2015	Life	Non-life
China Life	309	-
NCI	246	-
Ping An	215	154
CPIC	225	201
PICC Gp	309	226
Taiping	325	171
PICC P&C	-	226
China Re	267	241

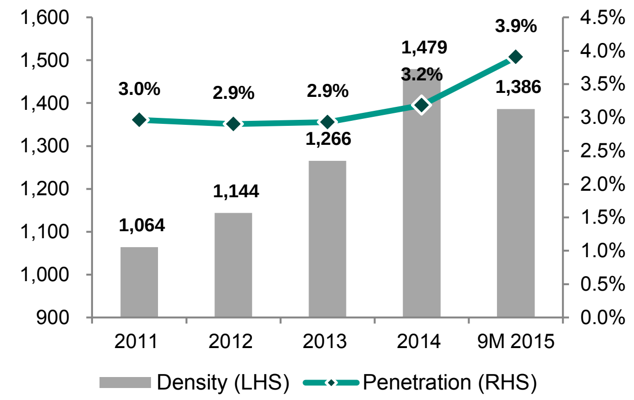
Source(s): Companies

Strong potential of Internet insurers. Ant Financial (a financial arm of Alibaba group), Tencent (700 HK), and Ping An jointly invested in the Internet P&C insurer - Zhong An Insurance, and the latter managed to break even in its first year of operation. Internet portal operators with high daily user flow, cloud computing, and large transaction volume will provide P&C insurers strong competitive edges.

Booming local corporate bond market enhances investment yields. We believe the removal of intermediaries in the banking sector will support growth in the high-yield enterprise/corporate bond markets. Insurers are able to secure higher return on fixed income securities to boost investment yield.

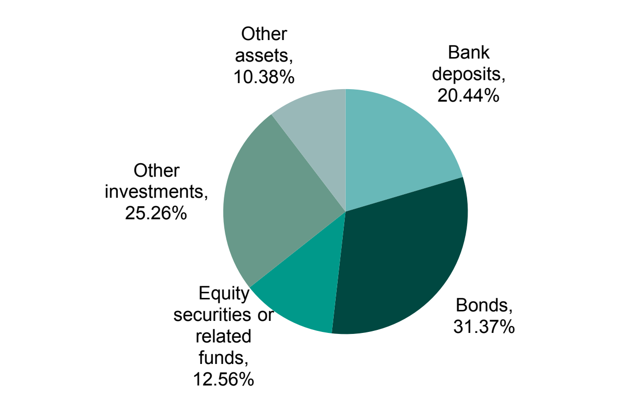
Risk factors: 1) Market liberalization risk; 2) Regulatory risk; 3) Investment risk; 4) Slowdown of economic and household income growth; 5) Potential cash calls; 6) Currency risk of foreign capitals; 7) Sector beta >1.40 (vs. HSI).

Exhibit 1: Insurance density (RMB per capita) and penetration (insurance premium/nominal GDP)



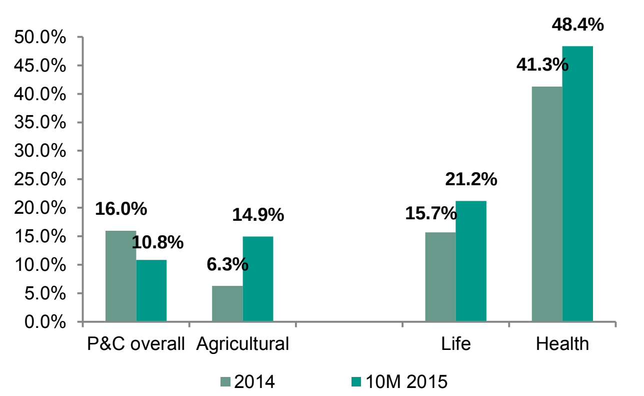
Source(s): CIRC, NBS, ABCI Securities

Exhibit 2: Insurance industry asset allocation (Oct 2015)



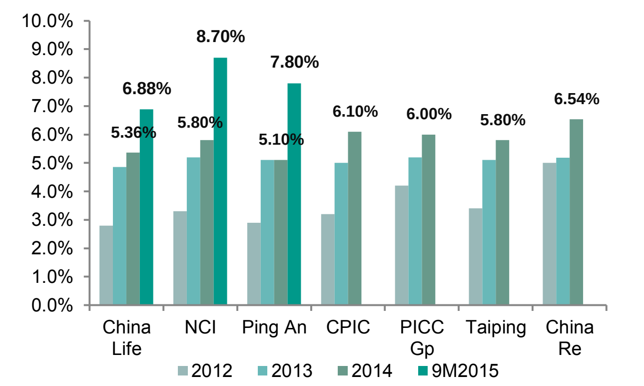
Source(s): CIRC, ABCI Securities

Exhibit 3: Total original premium growth (YoY)



Source(s): CIRC, ABCI Securities

Exhibit 4: Total investment yield of insurers



Source(s): Companies, ABCI Securities

Sector Valuation Summary (Data as of Dec 3, 2015)

Ticker	Company	Price (HK$)	EV (RMB)	Price / EV	FY15F PER	FY15F P/B	FY15F Yield(%)	FY15F ROAE(%)	FY16F PER	FY16F P/B	FY16F Yield(%)	FY16F ROAE(%)
2628	China Life	26.75	18.29	1.21	14.11	1.97	2.19	14.08	13.30	1.76	2.40	13.97
1336	NCI	34.70	31.81	0.90	9.66	1.55	1.06	16.55	9.52	1.35	1.14	15.15
2318	Ping An	44.25	28.96	1.26	11.99	1.84	1.30	16.13	11.45	1.61	1.40	15.02
2601	CPIC	33.45	21.39	1.29	15.17	1.88	2.24	12.60	15.10	1.72	2.31	11.90
1339	PICC Gp	4.09	2.98	1.13	8.26	1.28	0.33	15.64	8.77	1.10	0.33	13.51
966	Taiping	24.00	19.89	1.00	10.80	1.40	-	12.78	11.96	1.26	0.13	11.11
2328	PICC P&C	17.40	-	-	10.63	2.03	2.33	19.58	11.06	1.80	2.39	17.23
1508	China Re	2.50	1.69	1.22	10.42	1.19	1.70	12.31	10.27	1.09	1.41	11.07

Note: @HK$0.82559/RMB; EV: Embedded value per share
Source(s): Bloomberg, ABCI Securities estimates

Rise of the nursing

- Nuclear power will be the key alternative energy source in China as it is cleaner, more stable and efficient
- Nuclear power contributes to only 2% of China's total power output at present. We expect China's nuclear power output to expand by 20% CAGR in 2014-20F.
- Nuclear power operators should benefit more than the equipment maker as they are not subject to competition with overseas peers
- Maintain **OVERWEIGHT** on China's nuclear power sector

China Nuclear Power Sector

OVERWEIGHT

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Nuclear power will be widely adopted in China. We believe rising public concern on environmental issue and advantages of nuclear power over other alternative energy sources would accelerate development of nuclear energy in China over the next decade. Nuclear power operators are likely to record robust earnings growth in 2016 and beyond. We maintain an **OVERWEIGHT** sector rating.

Nuclear power should be the key alternative energy in future. We believe nuclear power should be the key alternative energy source in China to replace traditional coal-fired power. Nuclear power has several advantages over other alternative energy sources such as 1) lower production cost; 2) higher efficiency; 3) low pollution; 4) stable output under most weather conditions.

China's nuclear power output will expand by 20% in 2014-20. The average proportion of nuclear power to overall power output in the developed countries is ~ 30%, and the global average is 14%. In China, nuclear power output contributed to only 2% of China's total power output in 2014. According to the "Nuclear Power Mid-to Long-term Development Plan", the Chinese government targets to boost nuclear power capacity from 19.9GW by end-2014 to 58GW by end-2020, suggesting a 20% CAGR in 2014-20. If we assume 7,000 hours of utilization, the nuclear power output should rise by 20% CAGR in 2014-20F. In addition, we believe more nuclear encourage polices and development targets will be announced.

Prefer nuclear power operators. We believe China's latest nuclear power campaign will benefit the nuclear power operators. Unlike the equipment makers, nuclear power operators are not subject to competition with overseas peers as power generation right is only granted to local operators.

CGN Power (1816 HK, BUY). We prefer CGN because 1) it is the largest nuclear power operators in China; 2) most of its assets are located in wealthy coastal regions, including Guangdong. The stock is now trading at 18x/15x 2015/16E P/E based on Bloomberg consensus estimates, representing a 53%/54% discount to its closest peer, China National Nuclear Power (601985 CH, NR).

Risk factors: 1) Operational safety; 2) Falling utilization hours; 3) Construction risk 4) Tariff risk 5) Currency and interest rate risks 6) Policy risk.

Key Data

Avg.16F P/E (x)	23.50
Avg.16F P/B (x)	2.70
Avg.16F Dividend Yield (%)	1.60

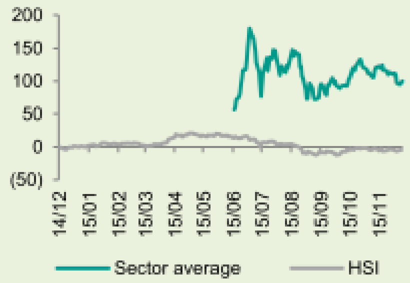
Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

	Absolute	Relative*
1-mth	(9.42)	(6.66)
3-mth	2.76	(4.81)
6-mth	(45.08)	(27.31)

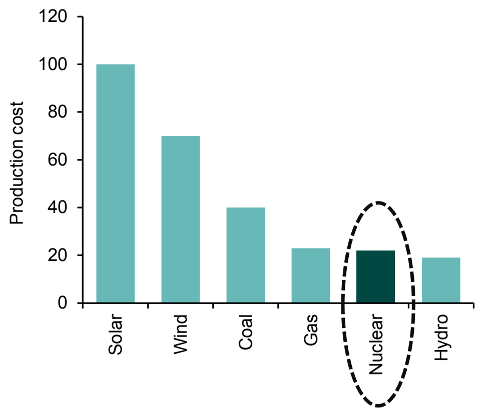
* Relative to HSI
Source(s): Bloomberg, ABCI Securities

1-Year Sector performance (%)



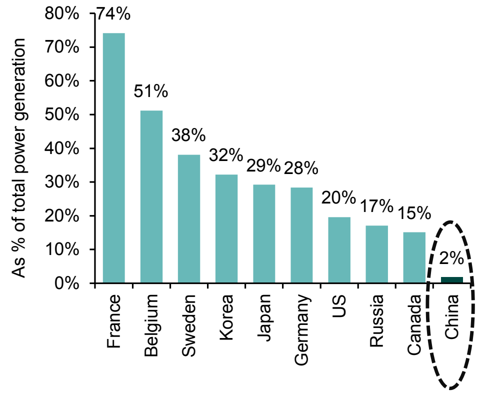
Source(s): Bloomberg, ABCI Securities

Exhibit 1: Nuclear power has a lower power generation cost than other energy sources



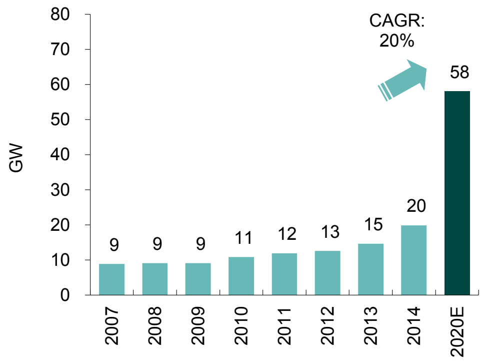
Source(s): Huadian Fuxin, ABCI Securities

Exhibit 2: Nuclear power still has much room to grow in China (2010)



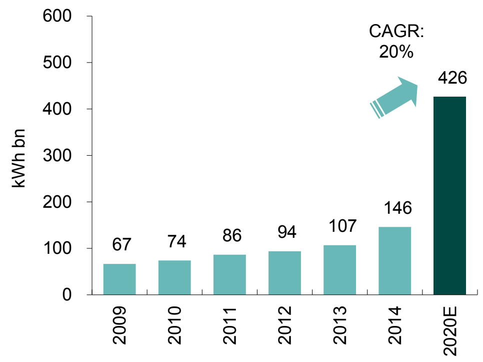
Source(s): Caijing.com, ABCI Securities

Exhibit 3: China's nuclear capacity is expected to undergo strong growth



Source(s): NEA, ABCI Securities estimates

Exhibit 4: Nuclear power output in China will surge



Source(s): NEA, ABCI Securities estimates

Sector Valuation Summary (Data as of Dec 3, 2015)

Ticker	Company	Price	Mkt Cap (USDmn)	P/E (x) FY15F	P/E (x) FY16F	P/B (x) FY15F	P/B (x) FY16F	Div Yield(%) FY15F	Div Yield(%) FY16F	ROE(%) FY15F	ROE(%) FY16F
HK & China											
1816 HK	CGN Power Co Ltd	2.98	17,475	17.6	14.9	1.9	1.7	2	2	11	12
601985 CH	China National Nuclear	9.92	24,183	37.3	32.1	4	3.7	1	1	13	12
Avg.				**27.4**	**23.5**	**3**	**2.7**	**1**	**2**	**12**	**12**
Asia											
9501 JP	Tokyo Electric Power	766	10,027	3.8	8.4	0.5	0.6	0	0	12	5
9503 JP	Kansai Electric Power	1,420	10,859	10.7	11.7	1.1	1	1	1	10	10
9508 JP	Kyushu Electric Power	1,357	5,242	12.6	9.1	1.4	1.3	1	1	13	14
015760 KS	Korea Electric Power	48,950	27,006	6.7	5.4	0.5	0.4	3	3	21	9
Avg.				**8.5**	**8.7**	**0.9**	**0.8**	**1**	**1**	**14**	**10**
International											
EOAN GR	E.On Se	8.96	19,548	10.9	11.5	0.8	0.8	6	6	7	7
EDF FP	Edf	13.49	27,345	6.7	7.3	0.7	0.7	9	9	11	10
DUK US	Duke Energy Corp	66.23	45,588	14.4	14	1.1	1.1	5	5	8	8
NEE US	Nextera Energy Inc	96.42	44,405	17.1	15.6	1.9	1.9	3	4	12	12
EXC US	Exelon Corp	27.14	24,957	10.8	10.9	0.9	0.9	5	5	9	8
FE US	Firstenergy Corp	32.05	13,558	11.9	11.3	1	1	4	5	9	9
ETR US	Entergy Corp	64.36	11,481	11.2	12.8	1.1	1.1	5	5	10	9
Avg.				**11.9**	**11.9**	**1.1**	**1.1**	**5**	**5**	**9**	**9**

Source(s): Bloomberg, ABCI Securities estimates

Rise and shine in 2016

- Continuous policy support via rate cuts and sector-specific policies such as mortgage relaxation will support property sales in China
- Active domestic corporate bond issuance should lower finance cost for developers and provide more flexibility for fund use
- Expect property price to grow by 5% in 2016F; prices in first-tier cities may increase by 10%

China Property Sector

OVERWEIGHT

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A year of policy support. Since Nov 2014, China has slashed interest rates six times or 165bps while RRR has been reduced from 20% to 17.5%. Declining interest rates lower finance cost for highly-geared developers and lessen financial burden of mortgage buyers. The government has also boosted property demand by: **1) Increasing investment demand.** Except in tier-one cities and Sanya, home-purchase restriction was removed by end -2014 in most regions; down payment ratio for second-home mortgage was also lowered from 50% to 40% in Mar 2015; **2) Increasing demand in lower-tier cities where inventory levels are high.** In Sep 2015, the down-payment ratio was reduced from 30% to 25% for cities without home-purchase restriction. More supportive policies will be launched, especially in lower-tier cities. For 2016F, we expect property price to grow by 5% YoY on average across China; for tier-1 cities, the growth would be higher at 10% YoY.

Finance cost eases on active corporate bond issuance. In 10M15, major developers in China issued a total of RMB 131.8bn of public domestic corporate bonds. The amount was higher than the total offshore USD bond aggregating to US$ 8.3bn (or RMB 53bn) for the period. Major benefits of PRC domestic corporate bonds, as compared to the overseas ones, include: 1) A lower interest rate. The average coupon rate was only 4.93% for domestic corporate bonds, compared to 8.22% for offshore ones; 2) No exchange rate risk; 3) More freedom in proceeds allocation. Funds raised from domestic corporate bonds can be used for purposes such as construction, land acquisition, general working capital, etc. while those from offshore bonds can only be used for land acquisition only.

Wanda (3699 HK) is our top pick; we also prefer Evergrande (3333 HK) and Logan (3380 HK). Within the property sector, Wanda is our top pick given its high exposure in lower-tier cities, benefiting from recent policy relaxation. We also like Evergrande as the Group's finance cost should be reduced after multiple rate cuts. Logan is our favorite pick among small-/mid-cap developers given its high exposure in the rising property market of Shenzhen.

Risk factors: 1) Fierce land competition may erode margins; 2) Net gearing may surge on corporate bond issuance; 3) Corporate governance.

Key Data

Avg.16F P/E (x)	5.3
Avg.16F P/B (x)	0.7
Avg.16F Dividend Yield (%)	5.8

Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

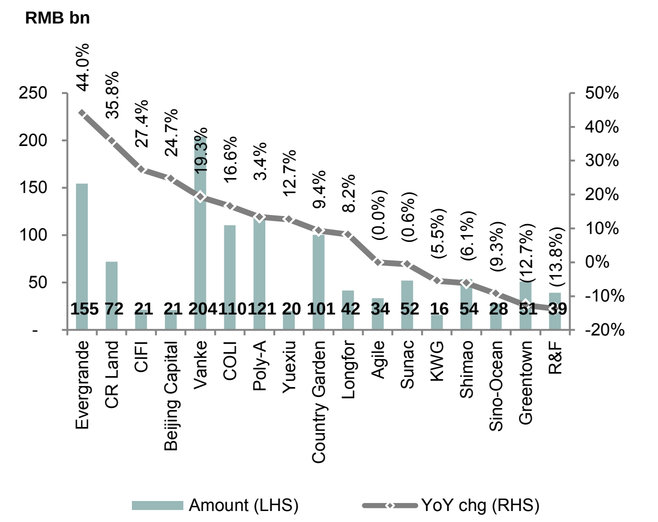
	Absolute	Relative*
1-mth	6.10	7.09
3-mth	21.61	14.53
6-mth	(10.82)	7.82

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

1-Year Sector performance (%)

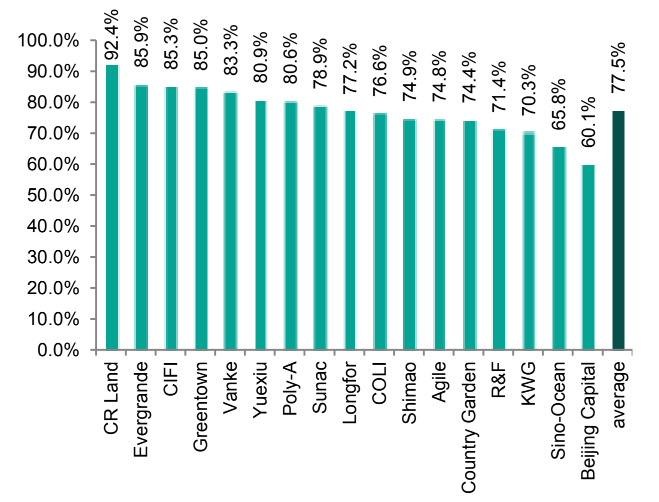
Source(s): Bloomberg, ABCI Securities

Exhibit 1: 10M15 presales



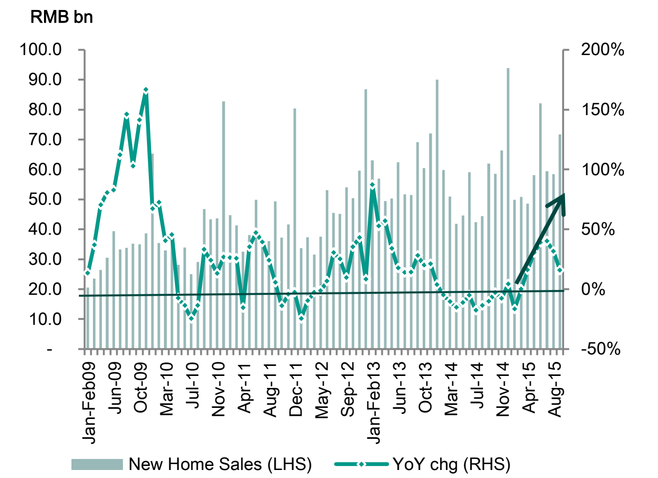
Source(s): Companies, ABCI Securities

Exhibit 2: Sales target completion ratio as at Oct 2015



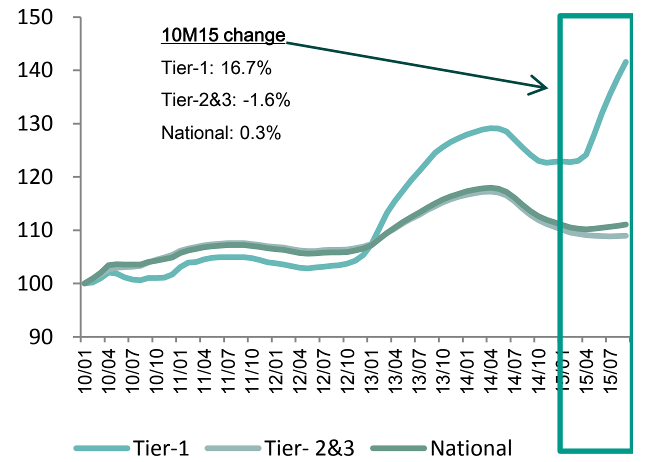
Source(s): Companies, ABCI Securities

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 Dec 3, 2015)

Ticker	Company	Rating	TP (HK$)	Upside (%)	FY15F P/E(x)	FY16F P/E (x)	FY15F P/B (x)	FY16F P/B (x)	FY15F Yield (%)	FY16F Yield (%)
3699 HK	Wanda	BUY	78.10	64	10.6	7.8	1.1	1.0	2.8	3.9
3333 HK	Evergrande	BUY	8.30	36	9.0	5.3	0.7	0.7	5.6	9.4
3380 HK	Logan	BUY	4.70	83	5.1	4.7	0.8	0.8	5.1	5.8
688 HK	COLI	BUY	32.00	17	9.2	6.5	1.3	1.2	2.2	3.1
817 HK	Jinmao	BUY	3.40	37	6.9	5.3	0.7	0.6	4.7	6.3
884 HK	CIFI	BUY	2.20	24	4.4	4.0	0.7	0.7	6.8	7.3
1918 HK	Sunac	BUY	9.40	64	5.2	4.0	0.8	0.7	3.5	4.5
1668 HK	CSC	BUY	3.20	79	4.1	3.0	0.6	0.6	10.6	13.4
3900 HK	Greentown	HOLD	6.60	(22)	4.8	4.9	0.6	0.5	5.7	6.5

Source(s): Bloomberg, ABCI Securities estimates

ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

China Solid Waste Sector

OVERWEIGHT

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The era of incineration

- With China's increasing urbanization rate, the Chinese government will need to improve solid waste treatment facilities in urban areas
- Increasing adoption of incineration technology should help operators achieve an earnings growth of 15-20% in 2016F
- We believe SOE players should benefit the most due to the lower interest rate and closer ties with local governments
- Maintain **OVERWEIGHT** on China's solid waste sector

Strong earnings growth to persist through 2016. We believe incineration will be the future key treatment method for residential solid waste and China is set to enter the decade-long incineration era. Incineration operators are likely to see robust earnings growth in 2016. Therefore, we maintain an **OVERWEIGHT** sector rating.

Increasing urbanization to spur incineration demand in the near future. According to NDRC's estimate, China's urbanization is likely to increase from 54% in 2013 to 60% in 2020. The current solid waste treatment system (mainly landfill) will become increasingly infeasible with the accelerating urbanization and demand for incineration facilities will rise.

China to accelerate adoption of incineration technology. About 70% of China's urban residential solid waste was treated via landfill at present while the rest is incinerated. The Chinese government targets to raise the proportion of waste incinerated from 30% at end-2013 to 45% by end-2020. This should present enormous opportunities to incineration operators in the near future. We therefore expect incineration operators to record a 15%-20% YoY earnings growth in 2016F.

Prefer SOE companies with prime assets. We believe SOE companies are more preferable than the private ones because (1) the former can attain a lower interest rate for borrowings; (2) they also have closer ties with local governments that give them an advantage over private and overseas companies in acquiring projects;(3) waste-to-energy projects of SOEs are located in wealthier regions with a relatively lower default risk.

China Everbright Int'l (CEI, 257 HK, BUY). We continue to favor SOE operators with prime assets. Most of CEI's existing waste-to-energy projects are located in wealthier coastal regions in China such as Suzhou, Jinan, Yixing, etc. In general, default risk is lower in the more affluent regions, which should allow the Group to maintain a stronger cash flow. The stock is now trading at 24x/18x 2015/16E P/E based on Bloomberg consensus estimates, which is similar to the international peer average of 23x/22x.

Risk factors: 1) Customer default risk; 2) Air pollution concern may delay construction of incinerators; 3) Policy risks.

Key Data

Avg.16F P/E (x)	18.00
Avg.16F P/B (x)	2.40
Avg.16F Dividend Yield (%)	1.40

Source(s): Bloomberg, ABCI Securities

Sector performance (%)

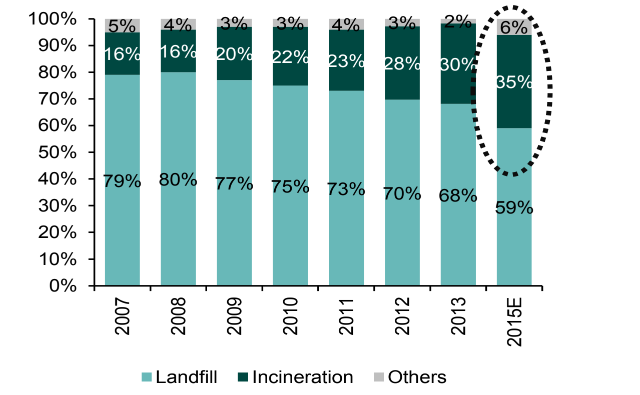
	Absolute	Relative*
1-mth	(4.94)	(2.18)
3-mth	22.90	15.34
6-mth	(14.02)	3.75

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

1-Year Sector performance (%)

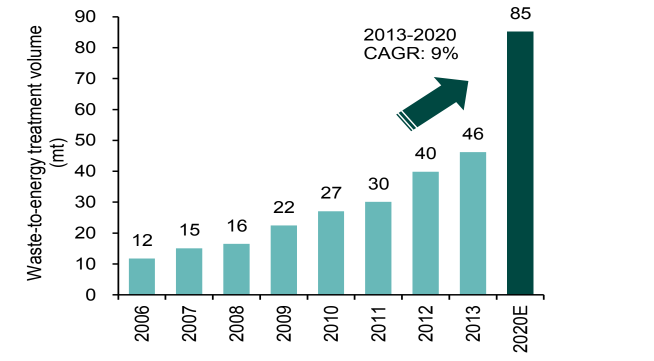
Source(s): Bloomberg, ABCI Securities

Exhibit 1: China is likely to increase the use of incineration for urban waste treatment



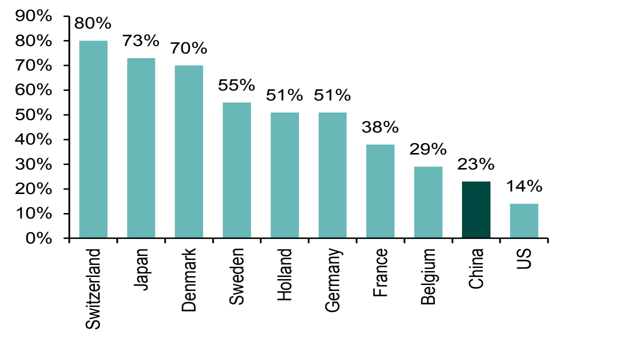
Source(s): MEP, ABCI Securities estimates

Exhibit 2: Volume of China's urban solid waste processed by waste-to-energy treatment will grow rapidly



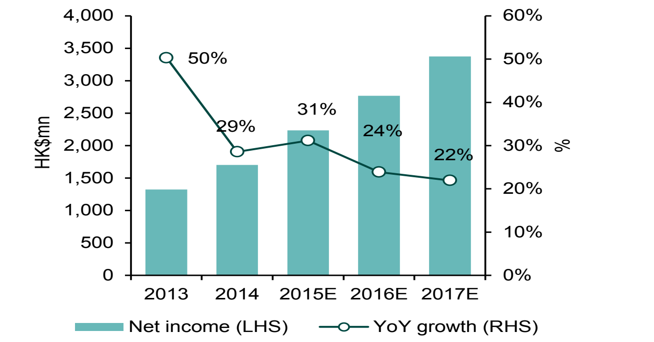
Source(s): MEP, ABCI Securities estimates

Exhibit 3: The global waste-to-energy treatment as a percentage of overall residential waste treated (2011)



Source(s): CB.com, ABCI Securities

Exhibit 4: CEI should maintain a strong earnings growth in the next few years



Source(s): Company data, ABCI Securities estimates

Sector Valuation Summary (Data as of Dec 3, 2015)

Ticker	Company	Price	Mkt Cap (USDmn)	P/E (x)		P/B (x)		Div Yield		ROE	
				FY15F	FY16F	FY15F	FY16F	FY15F	FY16F	FY15F	FY16F
HK & China											
257 HK	China Everbright Intl	11.94	6,908	23.9	18.2	3.0	2.6	1%	1%	13%	15%
895 HK	Dongjiang Environmental	12.74	2,426	26.5	18.6	2.6	2.1	1%	1%	12%	13%
Avg.				**25.2**	**18.4**	**2.8**	**2.4**	**1%**	**1%**	**13%**	**14%**
Asia											
5857 JP	Asahi Holdings Inc	1,969	581	10.3	9.0	-	-	3%	3%	11%	-
9793 JP	Daiseki Co Ltd	2,130	783	22.1	19.7	1.7	1.5	1%	1%	8%	9%
TPI AU	Transpacific Industries	0.68	790	20.0	16.2	0.6	0.6	3%	3%	3%	4%
Avg.				**17.5**	**15.0**	**1.1**	**1.1**	**2%**	**3%**	**7%**	**6%**
International											
RSG US	Republic Services Inc	43.57	15,129	21.3	20.2	2.0	1.9	3%	3%	8%	9%
WCN US	Waste Connections Inc	53.88	6,593	27.5	24.9	2.9	2.8	1%	1%	10%	11%
CLH US	Clean Harbors Inc	41.79	2,407	28.9	26.8	2.2	2.0	-	-	6%	7%
WM US	Waste Management Inc	51.84	23,146	20.1	18.7	4.3	3.9	3%	3%	13%	17%
BIN CN	Progressive Waste Solutions	30.33	2,478	19.0	17.8	2.1	1.8	3%	3%	11%	12%
Avg.				**23.4**	**21.7**	**2.7**	**2.5**	**2%**	**2%**	**10%**	**11%**

Source(s): Bloomberg, ABCI Securities estimates

Entering the golden decade

- The government's determination to reduce water pollution will provide enormous opportunities for wastewater treatment operators in the next decade. More supportive policies will be launched in 2016
- Urban wastewater volume to maintain robust to expand by 9% CAGR over 2013-20F
- Rising wastewater tariff remains positive for operators as this will improve their profitability.
- Maintain **OVERWEIGHT** on China's wastewater sector

Wastewater treatment to enter the golden decade. Wastewater treatment is one of main themes of China's environmental protection campaign in the 13th FYP. We believe wastewater treatment operators will experience a high growth over the next decade and therefore we maintain our **OVERWEIGHT** rating for the sector.

More treatment targets and supportive policies will be rolled out in 2016. More supportive policies, such as subsidies and favorable tax rate, will be launched after the announcement of the 13th FYP. To accelerate treatment rate, the government is likely to announce more details such as the wastewater treatment rate and investment budget- these will serve as positive catalysts for the sector in 2016.

Urban wastewater volume to grow at 9% CAGR over 2013-20F. We believe urbanization is a persisting trend in China. According to NDRC estimates, urbanization rate is likely to reach 60% in 2020 from 54% in 2013, suggesting an extra 140mn people will move into urban areas. In addition, increasing living and hygiene standards should boost wastewater treatment demand in urban areas and we therefore estimate China's wastewater treatment volume would expand by 9% CAGR in 2013-20F. This should offer great opportunities for wastewater treatment operators.

Rising wastewater tariff is a long-term positive to operators. China's nationwide wastewater tariff has been increasing at 9% CAGR during 2000-15, suggesting rising demand for urban wastewater treatment service. We believe the higher tariff should improve profitability among the operators.

Be aware of industrial and rural operators. China's weakening industrial production activities may slash profitability of industrial companies and increase default risk for wastewater treatment operators. In addition, disposable income of rural residents is much lower than that of their urban counterparts, indicating wastewater treatment operators in rural areas will bear a higher default risk.

Beijing Enterprises Water (BEW, 371 HK, BUY). We continue to favor BEW because (1) its SOE status would allow the Group to enjoy lower financing cost. Also, its close ties with local governments will also facilitate new project acquisition; (2) its operation that mainly focuses on wealthier regions where default risk are usually lower.

Risk factors: (1) Rising default risk as economic growth in China weakens; (2) High net gearing ratio may prompt fundraising activities; (3) Policy risks.

China Wastewater Sector

OVERWEIGHT

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Key Data

Avg.16F P/E (x)	25.10
Avg.16F P/B (x)	3.40
Avg.16F Dividend Yield (%)	1.40

Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

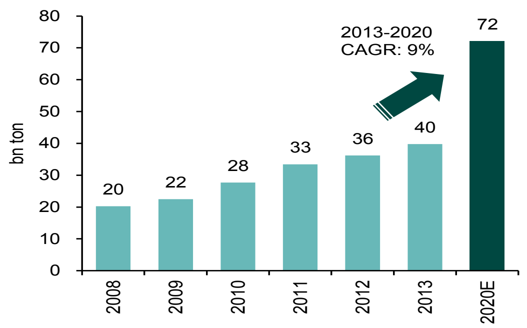
	Absolute	Relative*
1-mth	(4.23)	(1.47)
3-mth	27.21	19.64
6-mth	(10.01)	7.76

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

1-Year Sector performance (%)

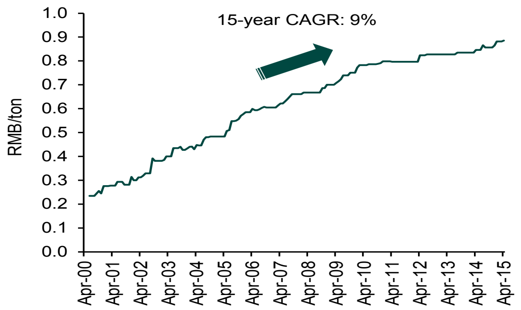
Source(s): Bloomberg, ABCI Securities

Exhibit 1: Volume of China's urban wastewater treatment should expand by 9% CAGR during 2013-20F



Source(s): CEIC, ABCI Securities estimates

Exhibit 2: Rising nationwide wastewater tariff is a long- term positive for wastewater treatment operators



Source(s): Wind, ABCI Securities

Sector Valuation Summary (Data as of Dec 3, 2015)

Ticker	Company	Price	Mkt Cap (USD mn)	P/E (x)		P/B (x)		Div Yield (%)		ROE (%)	
				FY15F	FY16F	FY15F	FY16F	FY15F	FY16F	FY15F	FY16F
HK & China											
371 HK	Beijing Enterprises Water	5.88	6,618	22.4	17.8	3.0	2.6	2	2	14	16
257 HK	China Everbright Intl	11.94	6,908	23.9	18.2	3.0	2.6	1	1	13	15
1363 HK	Ct Environmental Group	2.45	1,997	22.5	17.3	4.5	3.7	1	1	25	24
1065 HK	Tianjin Capital Environ	6.52	2,202	20.5	18.4	1.7	1.6	1	2	9	9
855 HK	China Water Affairs Group	4.04	792	15.0	12.7	1.5	1.3	2	2	10	11
601158CH	Chongqing Water Group	9.26	6,961	28.1	26.2	3.1	2.9	3	3	10	10
600874CH	Tianjin Capital	11.25	2,202	43.3	38.4	3.6	3.4	1	1	9	9
300070CH	Beijing Originwater	51.00	9,820	40.3	27.0	8.1	6.4	0	1	17	19
300055CH	Beijing Water Business	23.30	2,683	45.0	33.5	7.4	6.2	0	1	16	18
600187CH	Heilongjiang Interchina	5.89	1,343	45.3	39.3	-	-	-	-	-	-
600008CH	Beijing Capital Co Ltd	10.77	4,066	34.6	27.4	3.0	2.9	1	2	8	10
Avg.				**31.0**	**25.1**	**3.9**	**3.4**	**1**	**1**	**13**	**14**
Asia											
MWC PM	Manila Water Company	24.55	1,071	10.1	10.2	1.4	1.2	3	4	14	13
TTW TB	Ttw Pcl	10.70	1,191	15.0	15.5	3.7	3.7	6	6	24	23
EASTW TB	Eastern Water Resources	11.80	548	11.7	13.1	2.1	1.9	4	4	19	15
Avg.				**12.3**	**12.9**	**2.4**	**2.3**	**5**	**5**	**19**	**17**
International											
WTR US	Aqua America Inc	29.24	5,159	23.1	21.4	3.3	3.0	2	3	15	15
AWR US	American States Water	41.33	1,518	26.2	24.5	-	-	2	2	10	11
CWT US	California Water Service	22.55	1,080	22.2	18.4	1.6	1.6	3	3	8	9
Avg.				**23.9**	**21.4**	**2.5**	**2.3**	**2**	**3**	**11**	**11**

Source(s): Bloomberg, ABCI Securities estimates

Shift to renewables to spur demand

- To shift the national energy structure to renewables, China will continue to promote wind power in 2016
- National wind power capacity should see mid-teen growth in 2016F
- Wind power curtailment and falling power tariff are key challenges
- We prefer well-diversified players with a low all-in unit capacity cost
- Maintain **OVERWEIGHT** on China's wind energy sector

China Wind Power Sector

OVERWEIGHT

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Shifting from traditional energy to renewables. The Chinese government would continue to switch the national energy structure from traditional coal-fire to renewables to reduce air pollution. We believe wind energy sector will maintain a robust mid-teen growth in overall capacity and assign an **OVERWEIGHT** rating for the sector.

Nationwide wind power capacity growth should maintain a robust mid-teen growth in 2016F. We believe the government's determination to reduce air pollution will continue to facilitate wind power development in 2016. China's wind power capacity expanded by 40% CAGR in 2009-2014 and the government has targeted to attain an installed capacity of 200GW by end-2020, suggesting a 13% CAGR 2014-2020. Wind power capacity and output should maintain a robust mid-teen growth in upcoming years.

Wind power curtailment and the falling power tariff as key challenges. Wind power curtailment is a result of the bottleneck in transmitting energy from energy-rich regions to energy-short ones. Since the Chinese government is targeting to lower wind power tariff to compete with coal-fire power on cost and encourage the switch to renewable energy, wind power tariff should continue to trend down.

Prefer well-diversified players with a low all-in unit capacity cost. We believe operators with geographically diversified assets would be less impacted by power curtailment. For operators, a low all-in unit capacity cost (including labor) means they can expand their capacity without significantly increasing net gearing ratio and fundraising activities.

China Longyuan Power (916 HK, BUY). The Group is our top pick in the wind power sector because of (1) its well-diversified wind power assets that help reduce negative impacts resulting from wind power curtailment; (2) its lowest all-in unit capacity cost among peers means it can expand capacity with less financial resources; (3) its lowest net gearing ratio among peers implies less fundraising needs.

Huaneng Renewables (958 HK, BUY). We believe Huaneng will be the fastest-growing wind power play in China with its aggressive expansion plan and firm support by its parent company, Huaneng Group. Its capacity, which grew at 37% CAGR in 2009-14, should continue to increase at a mid-teen level annually.

Risk factors: (1) High gearing level among power players; (2) Natural resources risks; (3) Grid connection risks; (4) Policy risks; (5) Economic slowdown.

Key Data

Avg.16F P/E (x)	8.40
Avg.16F P/B (x)	0.81
Avg.16F Dividend Yield (%)	2.60

Source(s): Bloomberg, ABCI Securities estimates

Sector performance (%)

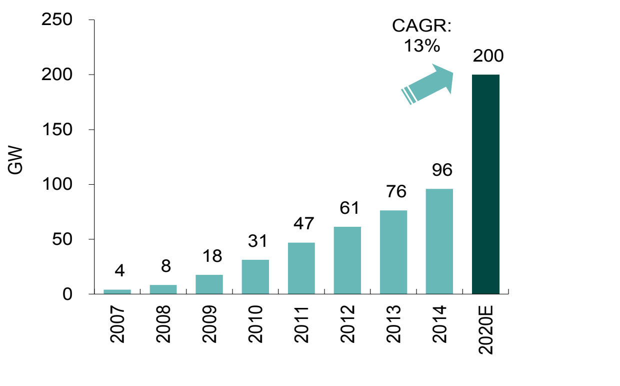
	Absolute	Relative*
1-mth	(2.18)	0.58
3-mth	(6.19)	(13.76)
6-mth	(31.80)	(14.04)

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

1-Year Sector performance (%)

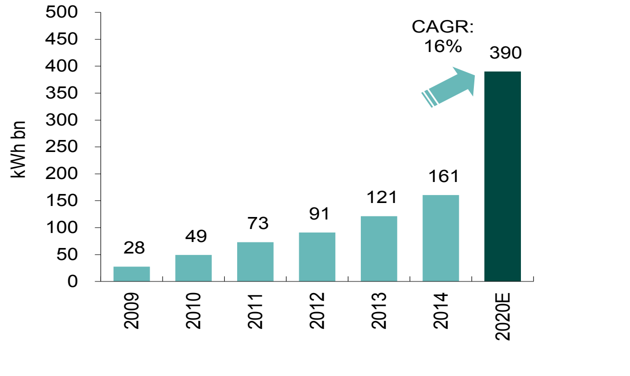
Source(s): Bloomberg, ABCI Securities

Exhibit 1: China's wind power capacity will maintain a robust growth



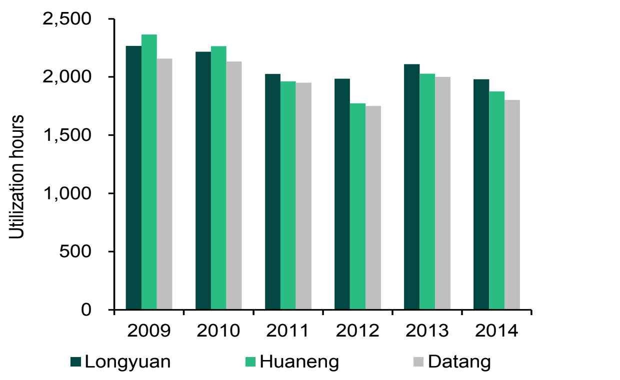
Source(s): NEA, ABCI Securities estimates

Exhibit 2: China wind power output is likely to see mid-teen growth during 2014-20



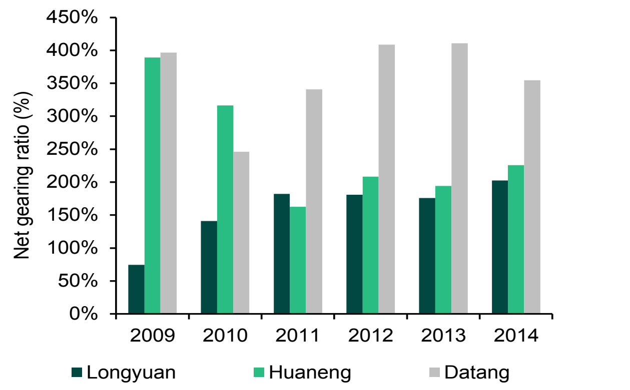
Source(s): NEA, ABCI Securities estimates

Exhibit 3: Well-diversified wind power assets should increase utilization hour



Source(s): Company data, ABCI Securities

Exhibit 4: A lower net gearing ratio will facilitate capacity growth



Source(s): Company data, ABCI Securities

Sector Valuation Summary (Data as of Dec 3, 2015)

Ticker	Company	Price	Mkt Cap (USD mn)	P/E (x) FY15F	P/E (x) FY16F	P/B(x) FY15F	P/B(x) FY16F	Div Yield (%) FY15F	Div Yield (%) FY16F	ROE (%) FY15F	ROE (%) FY16F
HK & China											
916 HK	China	6.48	6,719	11.7	10.0	1.2	1.1	2	2	11	11
958 HK	Huaneng	2.44	3,063	10.7	8.5	1.1	1.0	2	2	11	12
1798 HK	Datang	0.92	863	15.8	11.5	0.5	0.5	1	1	3	4
816 HK	Huadian	2.32	2,517	7.4	5.9	0.9	0.8	3	3	13	15
579 HK	Beijing	2.83	2,509	8.1	7.3	1.1	1.0	3	3	14	15
956 HK	China	1.27	609	9.4	7.4	0.5	0.5	3	4	6	7
Avg.				**10.5**	**8.4**	**0.9**	**0.8**	**2**	**3**	**10**	**11**
International											
ANA SM	Acciona SA	79.06	4,935	24.7	22.0	1.3	1.3	3	3	6	6
FTRN FP	Futuren SA	0.58	118	-	-	0.0	0.0	-	-	(4)	(1)
EDPR PL	Edp	6.55	6,233	40.0	31.8	1.0	0.9	1	1	3	3
GES DC	Greentech	6.70	104	12.0	12.0	0.5	0.5	1	1	4	4
Avg.				**25.5**	**21.9**	**0.7**	**0.7**	**1**	**1**	**2**	**3**

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）.

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 2011-2015
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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