

GREATER CHINA**China: Offshore (H) 4.5 Stars — Very Attractive, Onshore (A) 3.5 Stars — Attractive**

- Caixin China Manufacturing PMI was 51.6 in August, increasing from 51.1 in July 17
- Exports growth slowed to 5.5% y-o-y in August, compared with 7.2% in July 17
- Imports growth increased to 13.3% y-o-y in August, compared with 11.0% in July 17
- CPI came at 1.8% y-o-y in August, higher than 1.4% in July 17
- PPI rose 6.3% y-o-y in August, increasing from 5.5% in July 17
- Retail sales grew 10.1% y-o-y in August, slightly lower than 10.4% in July 17
- Fixed asset investment (FAI) grew 7.8% YTD y-o-y in August, compared with 8.3% in July 17
- Industrial production growth slowed 6.0% y-o-y in August, down from 6.4% in July 17

Hong Kong: 4.5 Stars—Very Attractive

- Nikkei Hong Kong Manufacturing PMI fell to 49.7 in August from 51.3 in July 17
- The seasonal adjusted unemployment rate came at 3.1% in August, flat with that in July 17
- Foreign exchange reserves in Hong Kong reached higher to 413.7 USD billion in August, compared with 413.3 USD billion in July

Taiwan: 4.0 Stars — Very Attractive

- Nikkei Taiwan Manufacturing PMI picked up to 54.3 in August from 53.6 in July 17
- Taiwan's CPI came in at 0.96% y-o-y in August, slightly higher than 0.77% in July 17
- Exports grew 12.7% y-o-y in August, slightly higher than the growth rate of 12.5% YoY in July 17
- Imports increased 6.9% y-o-y in August, slightly higher than 6.5% y-o-y in July 17
- Industrial production came down to 3.25% y-o-y in August, compared with 2.38% in July 17

MARKET OUTLOOK

China's economic data continued to soften in August. In particular, industrial production growth declined to 6.0% year-on-year in August from 6.4% in July. The lower industrial production growth in August may be attributable to the ongoing environmental policy tightening that depressed the output growth of heavy industries and the construction activities, most of which are polluting industries. Furthermore, mainly due to the slowdown of infrastructure and manufacturing investment growth, fixed asset investment (FAI) growth moderated to 7.8% year-to-date year-on-year, down from 8.3% in July. However, both CPI and PPI picked up notably in August. CPI rose 1.8% year-on-year from 1.4% year-on-year in July, partially driven by the lower base but also pushed up by rising food prices, whereas PPI jumped to 6.3% from 5.5% previously, thanks to stricter environmental policy and resilient cyclical demand. Sector wise, prices of ferrous and non-ferrous metal mining and processing continued to see a notable month-on-month rise in August, while price of petroleum and gas also picked up visibly. On the other hand, export growth slowed to 5.5% year-on-year, but the exports under ordinary trade and processing trade grew steadily. Meanwhile, import growth accelerated, supported by higher commodity prices as well as resilient domestic demand. This also proved that the recent appreciation of the RMB against USD should not be a large drag on exports, given that the RMB did not appreciate significantly against a basket of currencies. Also, many cities rolled out new property market tightening measures over this month; we believe these measures are mainly to further tighten housing markets in lower tier cities, and housing sales are likely to weaken further in the medium term. However, the extent of real economic impact will mainly depend on the progress of real estate investment; if it remains to be resilient, the impact will be limited. Overall, we believe that softening economic data is not indicative of the long-term trend and any sharp slowdown is unlikely to happen; economic momentum will likely slow in 4Q 17, but still be above target for 2017.

Taiwan's economic data continued to show positive signals. The leading indicators such as Nikkei Taiwan Manufacturing PMI continued to stand above 50 at 54.3 in August, which indicated business activity is still expanding. Both exports and imports data have surprised to the upside in August, with 12.7% and 6.9% year-on-year growth rates respectively. Exports to China, ASEAN and Japan grew at a faster pace, even to the US and Europe also picked up moderately. Given the pipeline of new product of launches and new technological applications, the exports of electronic products, machinery and information and communication products may continue to increase. Meanwhile, we believe the improving global economic environment as well as the rising demand for technology equipment, in particular China and the US (Taiwan's key trading partners) will lend strong support to Taiwan's economy.

As at 22 September 2017, the CSI 300 Index is currently trading at estimated PE ratios of 14.7X and 13.0X based on estimated earnings in 2017 and 2018 respectively, a discount to its fair value of 15.0X, while the HSML100 Index is trading at 10.8X and 9.7X (based on estimated earnings in 2017 and 2018 respectively) as compared to our fair PE of 13.0X. We continue to prefer H-shares to the onshore market. We maintain our **4.5 Stars "Very Attractive" rating for the offshore Chinese equity market**. Moreover, the Hong Kong equity market is currently trading at estimated PE ratios of 12.7X and 11.7X based on estimated earnings in 2017 and 2018 respectively, below its fair value of 15.0X. Therefore, we maintain our **4.5 Stars "Very Attractive" rating for Hong Kong**. Lastly, Taiwan is trading at estimated PE ratios of 14.8X and 13.7X based on 2017 and 2018 earnings estimated respectively, slightly higher than our fair PE ratio of 14.0X. We thus maintain a **4.0 Stars "Very Attractive" rating for Taiwan**.



M3 STAR RATINGS REVIEW

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China (4.5 Stars – Very Attractive)

China A – 3.5 STARS (Attractive)

Why we like it

1. Opening up of the onshore Chinese market
 - China and Hong Kong launched a long-awaited bond connect scheme in July 2017, which links China's \$9 trillion bond market with overseas investors. Investors from Mainland China and overseas can trade in each other's bond markets via the scheme. The connection encourages global investors to hold more Yuan-denominated assets, which accelerates the process of RMB internationalization. We expect the scheme to attract more institutional and professional investors to the market.
2. Economic stabilization
 - China's industrial production growth seems to lose momentum in the third quarter, which partially results from ongoing environmental policy. However, both CPI and PPI picked up notably in August. CPI rose to 1.8% year-on-year from 1.4% year-on-year in July, partially driven by the lower base but also pushed up by rising food prices, whereas PPI jumped to 6.3% from 5.5% previously, thanks to stricter environmental policy and resilient cyclical demand. Overall, the economy remains stable, and the rebound in the economy will increase the profitability and earnings of corporates and consequently benefit the market.
3. Inclusion of A-shares in the MSCI Emerging Markets basket
 - MSCI plans to include China A shares in the MSCI Emerging Markets Index and the MSCI ACWI Index starting in June 2018. It is an important milestone in the integration of China's equity markets with the rest of the world. The move could trigger an inflow of around USD 9 billion and more than USD 200 billion into China's equities over the next five years. Furthermore, the event may well drive the A-share market valuation and the global market convergence in the long run.
4. Attractive Valuations in H-shares
 - The Chinese H-share market still presents attractive upside as the equity market continues to be supported by easing measures and reform measures. Valuations remain attractive. According to market consensus, as at 22 September 2017, the HSML100 Index is trading at 10.8X and 9.7X (based on estimated earnings in 2017 and 2018 respectively) as compared to our fair PE of 13.0X as of 22 September 2017, while the CSI 300 Index is currently trading at estimated PE ratios of 14.7X and 13.0X based on estimated earnings in 2017 and 2018 respectively, a discount to its fair value of 15.0X.

What we don't like

1. Fed balance sheet reduction
 - The US Federal Reserve officially announced that it would gradually reduce its balance sheet starting in October 2017, and USD 50 billion per month taper will start in October. As a result, the 10-year yield is expected to increase. Besides, the Fed is expected to raise rates one more time this year, which may well put downside pressure on RMB.
2. External uncertainty
 - After Donald Trump became the 45th US president this year, the trade relationship between the US and China is potentially under threat, and trade frictions may happen. Trump's preferences for trade protectionism and anti-globalisation have brought about uncertainty and serious concerns globally. During his election campaign, he accused China of being a currency manipulator and threatened to impose a punitive 45% tax on Chinese imports.