

Liquidity bleeding could persist in the near term

More pressure on liquidity in sight

Market sentiment has stayed weak in June so far, with a half-hearted market rebound followed by a quick correction. We think the market could face increased liquidity pressure in the near term due to: 1) concerns led by heightened chances of retaliatory actions relating to the trade dispute between China and the US; 2) the policy gap between the US Federal Reserve and other central banks such as the European Central Bank (ECB) and the Bank of Japan (BOJ), which is likely to boost USD in the near term and, as a result, lead to further fund outflows from emerging markets; and 3) southbound fund repatriation unlikely to reverse soon despite better performance of the Hong Kong market relative to the A-share market recently. As such, we continue to expect a [bumpy road](#) until the interim results season, when valuations will be more attractive and 1H18 financial data could provide more proof on continued growth quality improvement. Please refer to our [2H outlook](#) report for more details.

Trade dispute forcing risk appetite into a downward spiral

The US government decided to impose tariffs on USD50bn worth of imports from China, with the first batch of over 800 items worth USD34bn effective on 6 July (please refer to the full lists of the [first](#) and [second](#) batches). China responded shortly with tariffs on an equal amount of imports from the US, mainly on agricultural products and vehicles in the initial phase (please refer to the full lists of the [first](#) and [second](#) batches). The potential for a prolonged trade dispute could shake investor confidence and deter incremental inflows. In addition, as we [highlighted before](#), trade wars could potentially backfire on the global economic recovery and drive up inflation, which in turn challenges the monetary policies of central banks.

Near-term strong USD unfavorable to fund flows to EM

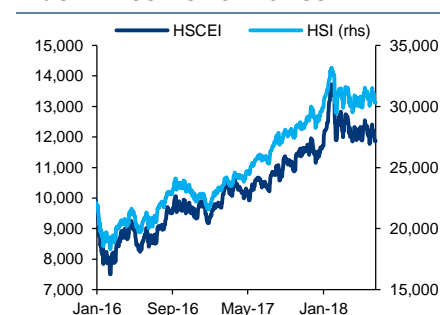
The strong USD index has diverted funds from emerging markets (EM) to developed markets since early May, with our tracker of the largest 50 ETFs tracking EM equities seeing an outflow of USD6.6bn since May (vs USD17.6bn inflows from January to April). The recent hawkish tone of the US Federal Reserve compared to the accommodating stances of the ECB and BOJ could contribute to a stronger USD in the near term, on the top of recent apparent divergence in US and Europe PMIs. We therefore expect potentially more pressure on the fund flows to Chinese companies, whereas Hong Kong local companies are likely more resilient.

Southbound outflows unlikely to reverse in near term

The Hong Kong market outperformed the A-share market in 2018 year to date despite the more challenging overseas environment. Since April, southbound outflows have reached HKD21.5bn (vs HKD119bn inflows from January to March). We think the outflows are unlikely to reverse because of subdued domestic investor sentiment, continued efforts in financial deleveraging, and lack of strong a catalyst for the Hong Kong market to break its current entanglement soon. Meanwhile, currently crowded sectors with high valuations, eg, healthcare, could potentially face more severe shocks should panic selling from southbound investors arise. In the wake of large new economy IPOs coming up, we take a prudent view on new economy names with stretched valuations and recommend investors to be selective on stocks with robust growth to justify valuations (please refer to our [previous note](#) for more details).

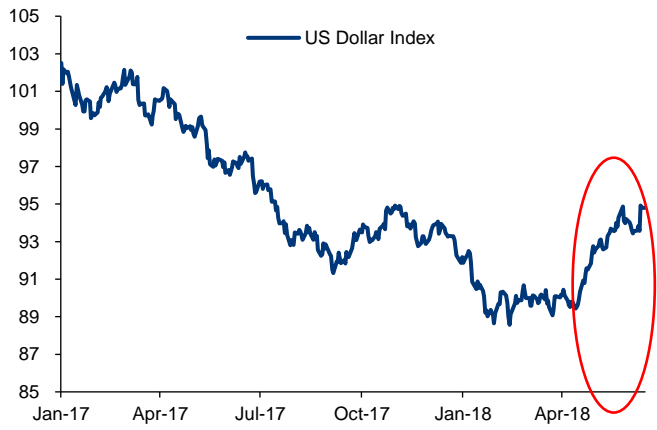
Cheng LV	+86 21 2897 2057
Strategist	lvcheng@htsc.com
Yi WANG	+86 21 2897 2057
Strategist	wangyi012893@htsc.com
Nan LI	+86 21 2897 2056
Strategist	li_nan@htsc.com

Index Price Performance



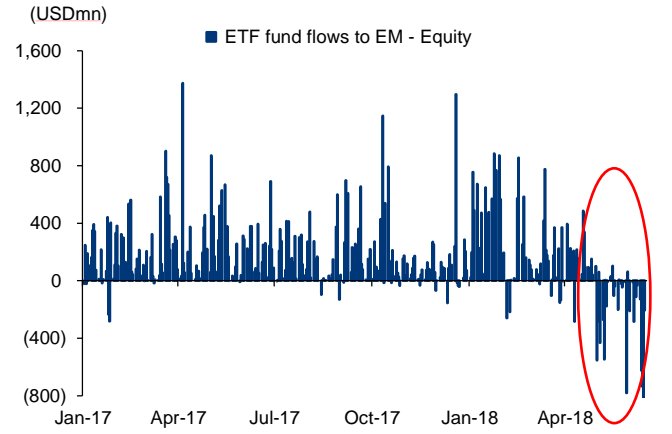
Source: Bloomberg, Huatai HK Research

Fig.1. US dollar index



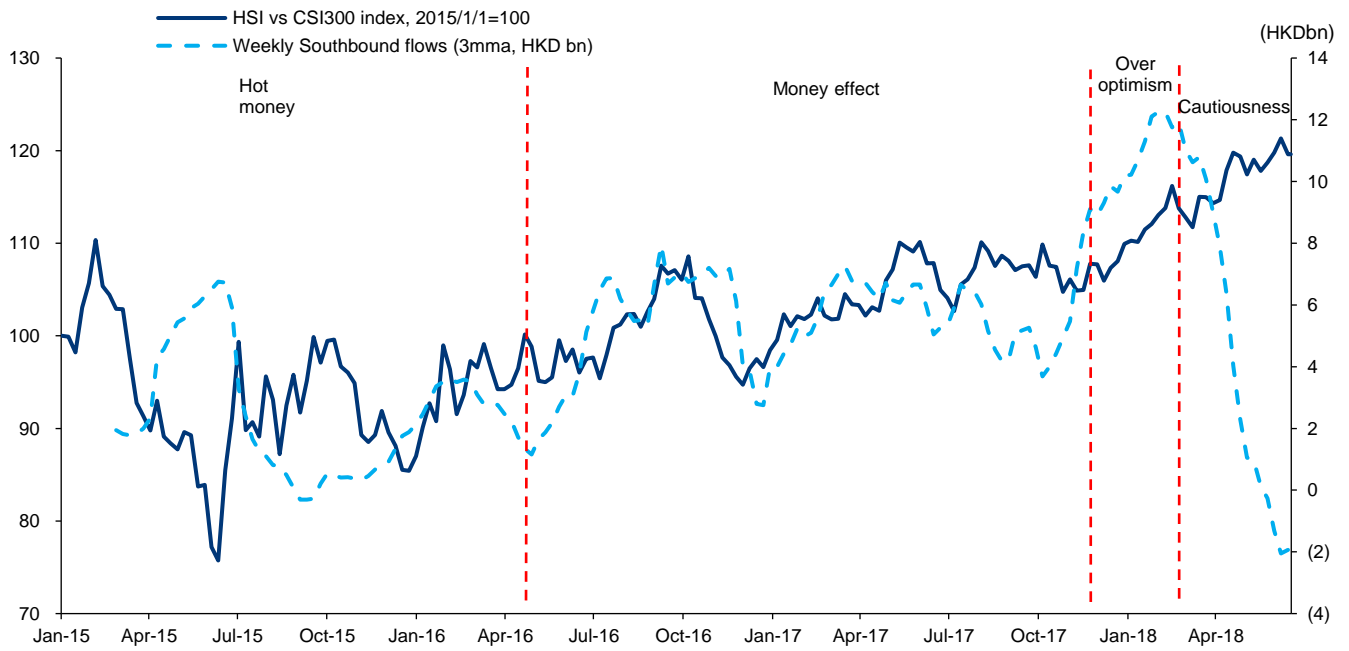
Note: data as at 15 June close;
Source: Bloomberg, Huatai HK Research

Fig.2. Fund flows of largest ETFs tracking EM equities



Note: data as at 15 June close;
Source: Bloomberg, Huatai HK Research

Fig.3. Weekly southbound flows (3mma) and HSI vs CSI300 index



Note: 3mma = three-month moving average; data as at 18 June close;
Source: Bloomberg, Wind, Huatai HK Research

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Unit 5808-12, 58/F, The Center, 99 Queens Road Central, Central, HONG KONG

Tel: +852 3658 6000
Fax: +852 2169 0770

Email: research@htsc.com
<http://www.htsc.com.hk/>

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Unit 5808-12, 58/F, The Center, 99 Queens Road Central, Central, HONG KONG

Tel: +852 3658 6000
Fax: +852 2169 0770

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