

Where is the market trough – a valuation check

A comparison to valuation troughs

The deteriorating liquidity condition and investor sentiment has dragged down the China/HK market, with HSI and HSCEI down 8.3/10.4% since 8 June. In addition to the factors [we highlighted before](#) — ie, trade-war, strong USD, and sluggish southbound flows — depreciated RMB became a new market concern (please refer to [our in-depth analysis on market implications of changes in USD/RMB](#)). We believe if the downward spiral in market sentiment exacerbates, which is unlikely to turn around until the next catalyst — interim results season — it may not be a good entry point yet. In this note, we examine the valuation troughs throughout history and look for sectors that are relatively safe and could potentially enjoy valuation rebound when market confidence reboots.

Overall market – mid-level in the historical range

Over the past decade, 12-month forward PE of HSCEI touched 6x twice: in 2008 when it sank to 5.5x during the global financial crisis and when it sank to 5.8x during the global risk-off at the beginning of 2016. Currently, excluding the effect of index enhancement, the index's 12-month forward PE is 6.9x, 0.9x standard deviation below its average level since 2011. HSI and overall southbound stocks are trading at 10.9x and 10.5x forward PE now, at par with their average since 2011. Forward PB of HSCEI (excluding effects of index enhancement), HSI, and overall southbound stocks are 0.8x, 1.2x, and 1.2x, respectively, all lower than the averages since 2011. The expected weak market performance in the near term could further bring down the overall market valuation, in our view, but it is unlikely to see a crisis-level valuation in the near future either, as long as risks are well contained and managed in the domestic market and the global economy doesn't see an abrupt downturn caused by trade war.

Sectors with relatively safer valuation buffers

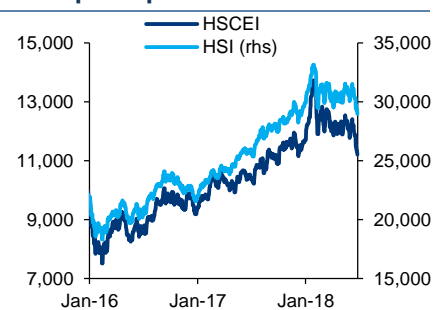
Among different sectors in the southbound stocks, most sectors are now trading at the mid-levels of their historical ranges, similar to the overall market, with a few exceptions. Forward PE of capital goods, insurance, diversified financials, real estate, commercial and professional services, and auto are closest to their historical troughs from 2011; meanwhile, those of healthcare, consumer durables, tech hardware, software and media are now closest to their peak levels. Forward PB of capital goods, diversified financials, telecoms, media, and banks are near their lowest levels since 2011; and healthcare, consumer durables, tech hardware, property, consumer services, and materials are closest to their highest levels.

Opportunities may emerge during interim results season

Despite our cautious view in the short term, we expect the market to regain traction entering the interim results season (please refer to [detailed rationales](#)). Sectors with cheap valuations compared to their historical ranges could provide some buffer before the market regain its footing. Among these sectors, diversified financials, insurance, auto, and banks are likely to see better valuation expansion when the market sentiment recovers, in our view.

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Index price performance



Source: Bloomberg, Huatai HK Research

Fig.1. 12-month forward PE of southbound sectors (since 2011)

Sector	2017		Historical range (x)		Average & Median (x)		Distance to avg (SD)			Distance to median (SD)			Current Percentile (%)
	Current (x)	Year-end (x)	Min since 2011	Max since 2011	Average since 2011	Median since 2011	Current vs Avg	Min vs Avg	Max vs Avg	Current vs Median	Min vs Median	Max vs Median	
HSCEI*	6.9	7.9	5.8	11.0	7.8	7.8	(0.9)	(2.1)	3.3	(0.9)	(2.0)	3.4	13.5
Materials	7.0	8.4	5.4	12.4	8.9	8.7	(1.3)	(2.4)	2.4	(1.1)	(2.3)	2.5	9.7
Banks	7.2	7.9	5.2	10.5	7.3	7.2	(0.1)	(2.2)	3.5	(0.1)	(2.2)	3.5	49.2
Capital Goods	7.3	8.7	7.0	12.9	9.5	9.4	(2.2)	(2.5)	3.5	(2.1)	(2.4)	3.6	0.7
Real Estate	8.0	9.8	6.8	13.4	9.7	9.6	(1.6)	(2.6)	3.4	(1.5)	(2.6)	3.4	5.8
Auto	8.2	12.2	6.9	13.2	9.8	9.8	(1.4)	(2.5)	2.9	(1.3)	(2.4)	3.0	7.1
Energy	9.1	11.3	7.2	30.7	11.9	10.0	(0.6)	(1.0)	4.1	(0.2)	(0.6)	4.5	29.7
Overall SB stocks	10.5	12.1	8.3	12.9	10.7	10.5	(0.1)	(2.5)	2.4	0.0	(2.4)	2.5	50.5
Diversified Financials	10.7	12.8	7.5	20.3	14.7	14.9	(1.6)	(2.9)	2.3	(1.7)	(3.0)	2.2	4.1
HSI	10.9	11.8	8.0	13.2	10.9	10.8	(0.0)	(3.1)	2.5	0.0	(3.0)	2.6	50.6
Telecom	11.3	12.5	9.7	17.0	12.6	12.2	(0.9)	(2.1)	3.2	(0.6)	(1.8)	3.4	20.2
Commercial & Prof Svcs	11.6	13.4	7.7	28.7	16.2	14.0	(1.0)	(1.9)	2.8	(0.5)	(1.4)	3.3	6.1
Retailing	11.9	13.1	9.1	16.6	13.0	13.0	(0.7)	(2.4)	2.2	(0.7)	(2.4)	2.2	26.4
Insurance	12.1	15.3	9.9	19.0	14.5	14.3	(1.6)	(3.1)	3.1	(1.5)	(3.0)	3.2	3.5
Tech Hardware	13.8	14.9	9.1	18.2	12.7	12.5	0.6	(2.0)	3.1	0.8	(1.9)	3.2	78.9
Transportation	13.9	17.2	9.3	18.5	13.9	13.6	0.0	(2.3)	2.3	0.2	(2.1)	2.4	59.2
Utilities	14.2	13.7	11.8	16.0	14.1	14.0	0.2	(3.2)	2.8	0.2	(3.2)	2.8	59.2
Media	14.6	16.0	8.7	20.3	14.2	13.8	0.2	(2.1)	2.4	0.3	(2.0)	2.5	62.3
Consumer Durables	15.1	15.3	10.2	16.1	13.1	12.9	1.8	(2.6)	2.7	2.0	(2.4)	2.9	93.3
Consumer Svcs	19.5	24.9	12.0	26.3	19.1	18.9	0.1	(2.1)	2.1	0.2	(2.0)	2.1	55.1
Cons. Stap.	20.6	21.1	14.5	26.3	20.3	20.5	0.1	(2.3)	2.4	0.1	(2.3)	2.3	52.3
Healthcare	22.9	19.2	12.3	24.9	17.3	17.0	2.2	(2.0)	2.9	2.3	(1.8)	3.1	98.4
Software	30.5	36.6	16.3	40.2	27.8	28.3	0.5	(2.3)	2.5	0.4	(2.4)	2.4	70.0

Note: data for HSCEI excludes the effect of index enhancement implemented on 5 March and 4 June 2018; data as at 26 June close

Source: Bloomberg, Huatai HK Research

Fig.2. 12-month forward PE of southbound sectors (since 2006)

Sector	2017		Historical range (x)		Average & Median (x)		Distance to avg (SD)			Distance to median (SD)			Current percentile (%)
	Current	Year-end	Min since	Max since	Average	Median since	Current	Min vs	Max vs	Current vs	Min vs	Max vs	
	(x)	(x)	2006	2006	since 2006	2006	vs Avg	Avg	Avg	Median	Median	Median	
HSCEI*	6.9	7.9	5.5	25.1	10.0	8.3	(0.9)	(1.3)	4.4	(0.4)	(0.8)	4.9	8.2
Materials	7.0	8.4	3.8	26.4	10.8	9.8	(1.0)	(1.9)	4.3	(0.8)	(1.7)	4.6	7.6
Banks	7.2	7.9	5.2	16.7	9.4	7.9	(0.7)	(1.4)	2.4	(0.2)	(0.9)	2.9	29.6
Capital Goods	7.3	8.7	6.5	22.0	11.2	10.2	(1.3)	(1.6)	3.8	(1.0)	(1.3)	4.1	1.0
Real Estate	8.0	9.8	6.8	24.2	11.8	10.5	(1.1)	(1.5)	3.6	(0.7)	(1.1)	4.0	4.4
Auto	8.2	12.2	3.8	21.0	10.9	10.3	(1.0)	(2.5)	3.5	(0.7)	(2.3)	3.8	10.7
Energy	9.1	11.3	4.7	30.7	11.6	10.5	(0.6)	(1.8)	4.9	(0.4)	(1.5)	5.2	22.8
Overall SB stocks	10.5	12.1	7.2	21.1	12.0	11.5	(0.6)	(2.1)	3.9	(0.4)	(1.9)	4.1	34.2
Diversified Financials	10.7	12.8	7.5	34.5	16.6	16.1	(1.3)	(2.1)	4.1	(1.2)	(2.0)	4.2	4.3
HSI	10.9	11.8	6.9	21.5	12.1	11.7	(0.6)	(2.4)	4.4	(0.4)	(2.2)	4.6	33.8
Telecom	11.3	12.5	8.4	27.5	13.5	12.7	(0.8)	(1.8)	5.0	(0.5)	(1.5)	5.3	16.7
Commercial & Prof Svcs	11.6	13.4	4.3	44.0	17.6	16.0	(0.9)	(2.0)	3.9	(0.6)	(1.7)	4.1	13.9
Retailing	11.9	13.1	5.4	23.8	13.9	13.6	(0.6)	(2.6)	3.1	(0.5)	(2.6)	3.2	23.3
Insurance	12.1	15.3	9.9	44.0	18.7	15.7	(1.0)	(1.4)	4.0	(0.6)	(0.9)	4.4	2.1
Tech Hardware	13.8	14.9	3.9	18.9	12.7	12.6	0.5	(3.5)	2.5	0.5	(3.5)	2.5	68.0
Transportation	13.9	17.2	7.2	25.1	14.4	13.6	(0.2)	(2.4)	3.5	0.1	(2.1)	3.8	56.6
Utilities	14.2	13.7	11.8	18.1	14.5	14.3	(0.2)	(2.2)	3.1	(0.1)	(2.1)	3.2	45.7
Media	14.6	16.0	7.0	20.3	14.3	14.1	0.1	(2.9)	2.4	0.2	(2.9)	2.5	57.2
Consumer Durables	15.1	15.3	7.0	24.4	14.1	13.5	0.4	(2.8)	4.1	0.6	(2.6)	4.3	69.2
Consumer Svcs	19.5	24.9	1.6	49.5	23.4	21.4	(0.4)	(2.5)	3.0	(0.2)	(2.2)	3.2	37.7
Cons. Stap.	20.6	21.1	12.8	31.9	21.1	21.0	(0.1)	(2.3)	3.0	(0.1)	(2.3)	3.0	45.1
Healthcare	22.9	19.2	4.4	24.9	16.0	16.5	1.6	(2.7)	2.1	1.5	(2.8)	2.0	96.7
Software	30.5	36.6	15.3	49.1	27.6	27.8	0.5	(2.3)	4.1	0.5	(2.4)	4.0	72.0

Note: data for HSCEI excludes the effect of index enhancement implemented on 5 March and 4 June 2018; data as at 26 June close

Source: Bloomberg, Huatai HK Research

Fig.3. 12-month forward PB of southbound sectors (since 2011)

Sector	2017		Historical range (x)		Average & Median (x)		Distance to avg (SD)			Distance to median (SD)			Current
	Current (x)	Year-end (x)	Min since 2011	Max since 2011	Average since 2011	Median since 2011	Current vs Avg	Min vs Avg	Max vs Avg	Current vs Median	Min vs Median	Max vs Median	percentile (%)
Capital Goods	0.72	0.85	0.70	1.37	0.89	0.86	(1.4)	(1.6)	4.0	(1.2)	(1.3)	4.2	0.2
Real Estate	0.76	0.87	0.50	1.20	0.74	0.73	0.2	(1.9)	3.7	0.3	(1.8)	3.8	62.3
HSCEI*	0.81	0.91	0.69	1.83	1.08	1.02	(1.1)	(1.6)	3.1	(0.9)	(1.4)	3.4	6.3
Banks	0.84	0.91	0.62	1.70	0.98	0.94	(0.7)	(1.8)	3.5	(0.5)	(1.6)	3.7	20.0
Energy	0.96	0.90	0.65	2.28	1.18	1.08	(0.6)	(1.4)	3.0	(0.3)	(1.2)	3.2	38.7
Materials	1.00	1.16	0.61	1.98	1.02	0.95	(0.1)	(1.5)	3.6	0.2	(1.3)	3.8	59.4
Telecom	1.02	1.20	1.01	1.84	1.45	1.44	(2.2)	(2.3)	2.0	(2.1)	(2.2)	2.1	1.0
Transportation	1.07	1.28	0.86	1.45	1.08	1.05	(0.0)	(1.7)	2.9	0.2	(1.5)	3.1	56.9
Overall SB stocks	1.20	1.34	0.88	1.84	1.25	1.23	(0.3)	(2.2)	3.6	(0.2)	(2.1)	3.6	36.6
HSI	1.21	1.25	0.92	1.80	1.25	1.25	(0.3)	(2.3)	3.8	(0.3)	(2.3)	3.8	32.7
Diversified Financials	1.21	1.43	1.21	3.74	2.01	1.95	(1.4)	(1.4)	3.1	(1.3)	(1.3)	3.2	0.2
Media	1.35	1.87	1.32	3.51	2.46	2.45	(2.3)	(2.3)	2.1	(2.2)	(2.3)	2.2	1.0
Retailing	1.47	1.50	1.04	3.33	1.79	1.64	(0.6)	(1.5)	3.1	(0.3)	(1.2)	3.4	24.6
Auto	1.53	2.37	1.04	2.51	1.71	1.68	(0.6)	(2.2)	2.6	(0.5)	(2.1)	2.8	27.1
Utilities	1.63	1.66	1.37	2.10	1.70	1.70	(0.5)	(2.5)	3.1	(0.6)	(2.6)	3.1	25.3
Insurance	1.69	2.03	1.24	2.61	1.86	1.83	(0.7)	(2.5)	3.0	(0.5)	(2.4)	3.1	24.8
Tech Hardware	1.80	2.91	1.18	3.69	1.81	1.70	(0.0)	(1.4)	4.1	0.2	(1.1)	4.4	67.1
Commercial & Prof Svcs	2.04	2.42	1.00	3.63	2.27	2.25	(0.4)	(2.4)	2.5	(0.4)	(2.3)	2.6	34.6
Consumer Durables	2.17	2.16	1.63	3.46	2.07	1.95	0.3	(1.2)	3.9	0.6	(0.9)	4.2	72.8
Healthcare	2.74	2.47	1.55	3.50	2.35	2.27	0.9	(1.8)	2.6	1.1	(1.6)	2.8	77.1
Cons. Stap.	2.79	2.90	1.71	3.76	2.79	2.81	0.0	(1.8)	1.7	(0.0)	(1.9)	1.6	49.2
Consumer Svcs	3.93	4.31	1.98	6.73	3.75	3.70	0.2	(1.9)	3.1	0.2	(1.8)	3.2	61.0
Software	7.37	9.41	4.63	10.75	7.34	7.40	0.0	(2.2)	2.8	(0.0)	(2.3)	2.7	48.2

Note: data for HSCEI excludes the effect of index enhancement implemented on 5 March and 4 June 2018; data as at 26 June close

Source: Bloomberg, Huatai HK Research

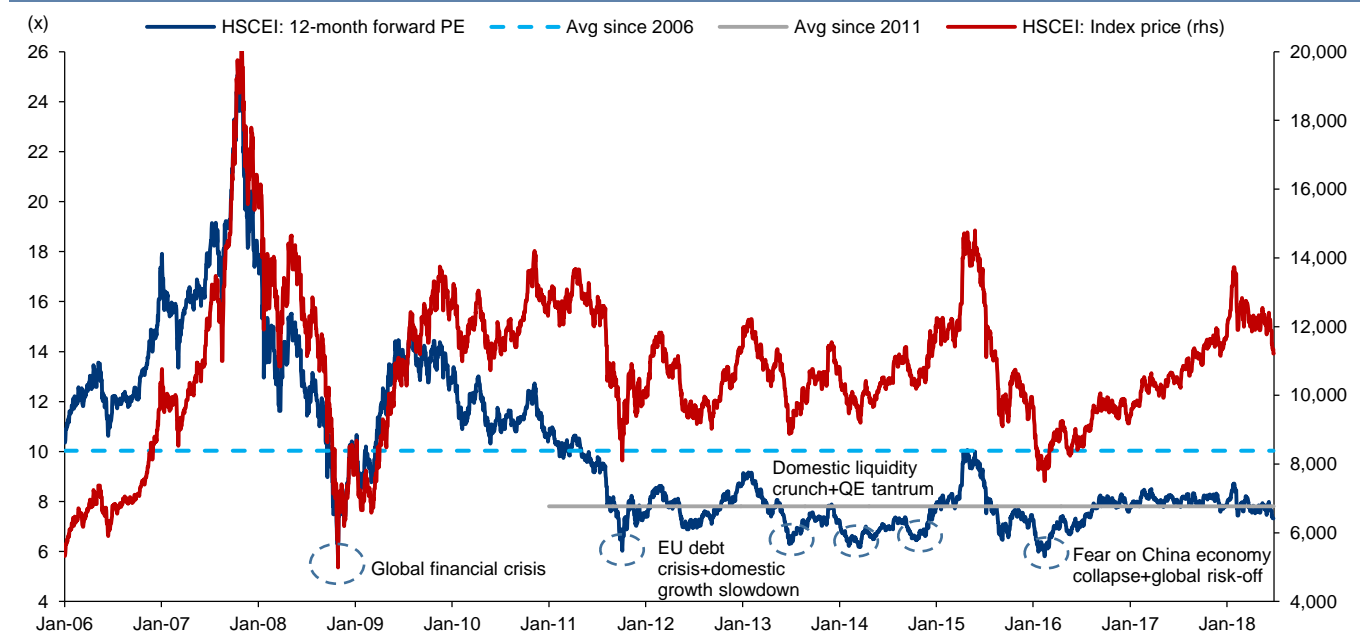
Fig.4. 12-month forward PB of southbound sectors (since 2006)

Sector	2017		Historical range (x)		Average & Median (x)		Distance to avg (SD)			Distance to median (SD)			Current percentile (%)
	Current (x)	Year-end (x)	Min since 2006	Max since 2006	Average since 2006	Median since 2006	Current vs Avg	Min vs Avg	Max vs Avg	Current vs Median	Min vs Median	Max vs Median	
Capital Goods	0.72	0.85	0.63	2.18	1.05	0.95	(1.1)	(1.5)	3.9	(0.8)	(1.1)	4.3	1.2
Real Estate	0.76	0.87	0.50	2.15	0.93	0.82	(0.5)	(1.3)	3.7	(0.2)	(1.0)	4.1	41.1
HSCEI*	0.81	0.91	0.69	4.48	1.53	1.26	(1.0)	(1.2)	4.3	(0.7)	(0.8)	4.7	3.7
Banks	0.84	0.91	0.62	2.82	1.39	1.12	(0.9)	(1.3)	2.4	(0.5)	(0.9)	2.9	11.9
Energy	0.96	0.90	0.65	4.38	1.58	1.46	(0.9)	(1.4)	4.1	(0.7)	(1.2)	4.3	23.3
Materials	1.00	1.16	0.59	5.63	1.54	1.14	(0.6)	(1.0)	4.4	(0.1)	(0.6)	4.9	37.0
Telecom	1.02	1.20	1.01	5.85	1.95	1.68	(1.0)	(1.1)	4.4	(0.7)	(0.8)	4.7	0.6
Transportation	1.07	1.28	0.68	2.64	1.24	1.15	(0.5)	(1.7)	4.2	(0.2)	(1.4)	4.5	38.8
Overall SB stocks	1.20	1.34	0.88	3.28	1.54	1.33	(0.7)	(1.4)	3.7	(0.3)	(0.9)	4.1	23.8
HSI	1.21	1.25	0.92	3.06	1.50	1.31	(0.7)	(1.5)	3.9	(0.3)	(1.0)	4.4	21.7
Diversified Financials	1.21	1.43	1.21	12.57	3.13	2.43	(0.9)	(0.9)	4.7	(0.6)	(0.6)	5.0	0.1
Media	1.35	1.87	1.32	5.12	2.75	2.58	(1.9)	(1.9)	3.2	(1.6)	(1.7)	3.4	0.6
Retailing	1.47	1.50	1.04	8.27	2.98	2.04	(0.7)	(1.0)	2.6	(0.3)	(0.5)	3.1	14.9
Auto	1.53	2.37	0.55	3.22	1.79	1.71	(0.5)	(2.5)	2.9	(0.4)	(2.3)	3.0	27.6
Utilities	1.63	1.66	1.37	2.49	1.83	1.78	(0.9)	(2.0)	2.9	(0.7)	(1.8)	3.1	16.5
Insurance	1.69	2.03	1.24	6.92	2.53	2.06	(0.8)	(1.3)	4.3	(0.4)	(0.8)	4.8	14.9
Tech Hardware	1.80	2.91	0.60	4.30	2.02	1.78	(0.3)	(2.0)	3.2	0.0	(1.6)	3.5	51.1
Commercial & Prof Svcs	2.04	2.42	0.47	4.62	2.27	2.28	(0.3)	(2.5)	3.3	(0.3)	(2.5)	3.3	36.5
Consumer Durables	2.17	2.16	1.27	4.69	2.44	2.18	(0.4)	(1.7)	3.2	(0.0)	(1.3)	3.6	49.3
Healthcare	2.74	2.47	0.82	3.93	2.22	2.15	0.8	(2.2)	2.6	0.9	(2.0)	2.7	77.1
Cons. Stap.	2.79	2.90	1.71	4.71	3.01	3.08	(0.3)	(1.9)	2.5	(0.4)	(2.0)	2.4	40.8
Consumer Svcs	3.93	4.31	0.60	6.73	2.99	2.97	0.7	(1.9)	3.0	0.8	(1.9)	3.0	76.6
Software	7.37	9.41	3.61	12.00	7.32	7.35	0.0	(2.5)	3.2	0.0	(2.5)	3.1	50.6

Note: data for HSCEI excludes the effect of index enhancement implemented on March and 4 June 2018; data as at 26 June close

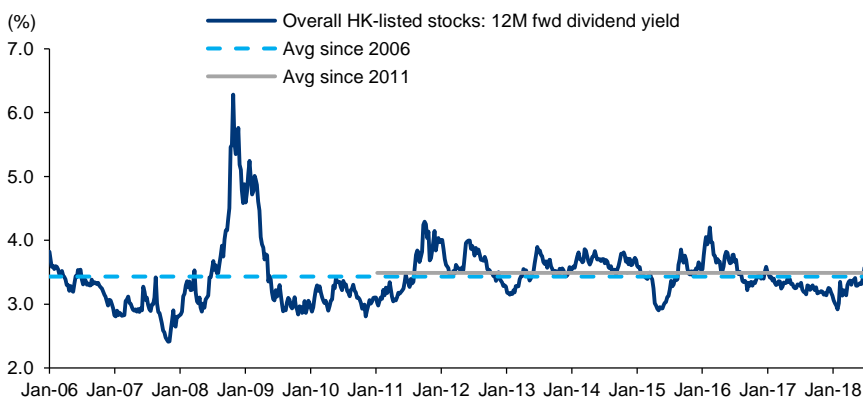
Source: Bloomberg, Huatai HK Research

Fig.5. 12-month forward PE of HSCEI: currently at 7.3 (with enhancements) or 6.9 (excluding enhancements)



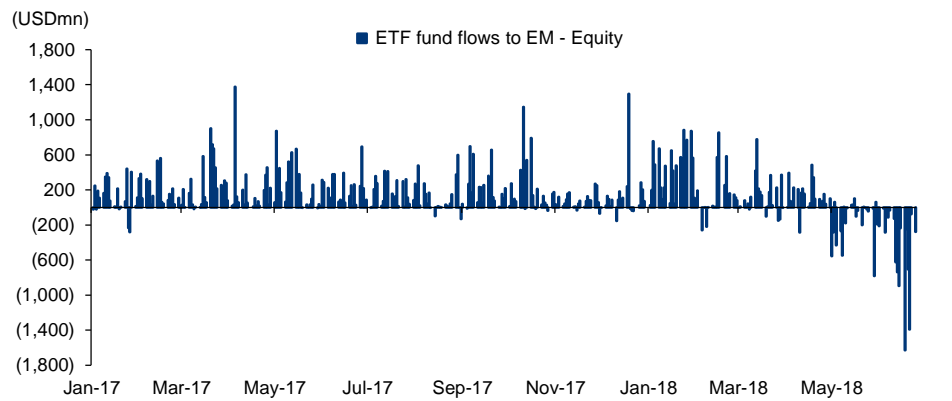
Note: data as at 26 June close
 Source: Bloomberg, Huatai HK Research

Fig.6. 12-month forward dividend yield of Hong Kong-listed stocks: current 3.6%



Note: data as at 26 June close
 Source: Bloomberg, Huatai HK Research

Fig.7. ETFs tracking emerging market equities continued with capital exodus



Note: includes the largest 50 ETFs tracking emerging market equities; data as at 25 June close
 Source: Bloomberg, Huatai HK Research

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Market Benchmark for is ()

Stock Rating Definitions

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HOLD: The analyst expects the stock to perform within -10%~15% vs the relevant market benchmark.

SELL: The analyst expects the stock to underperform below -10% vs the relevant market benchmark.

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Additional Information is available upon request.

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