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SECTOR REVIEW

GREATER CHINA

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

- Caixin China Manufacturing PMI was 51.6 in Feb 18, which was slightly higher than 51.5 in the prior month
- Exports growth increased by 36.2% y-o-y in Feb 18, compared with 6.0% in Jan 18
- Imports growth decreased by -0.2% y-o-y in Feb 18, compared with 30.2% in Jan 18
- CPI came at 2.90% y-o-y in Feb 18, higher than 1.50% in Jan 18
- PPI rose 3.70% y-o-y in Feb 18, slowing from 4.3% in Jan 18
- China's retail trade increased by 9.7% from a year earlier in Jan-Feb 18, following a 9.4% rise in Dec 17

Hong Kong: 4.5 Stars—Very Attractive

- Nikkei Hong Kong Manufacturing PMI increased to 51.7 in Feb 18 from 51.1 in Jan 18
- The seasonal adjusted unemployment rate came at 2.9% in Feb 18, flat with that in Jan 18
- Foreign exchange reserves in Hong Kong increased to USD 443,500 million in Feb 18 from USD 441,500 million in Jan 18

Taiwan: 4.0 Stars — Very Attractive

- Nikkei Taiwan Manufacturing PMI fell to 56.0 in Feb 18 from 56.9 in Jan 18
- Exports grew -1.20% y-o-y in Feb 18, much lower than the growth rate of 15.3% y-o-y in Jan 18
- Imports increased 0.90% y-o-y in Feb 18, much lower than 23.30% YoY in Jan 18
- Consumer prices in Taiwan increased 2.19% y-o-y in Feb 18, following a marginally revised 0.89% gain in the previous month

MARKET OUTLOOK

Caixin China Manufacturing PMI was at 51.6 in February, which remained above the boom-or-bust line of 50 that separates expansion from contraction, and was slightly higher than 51.5 in the prior month. Besides, exports account for RMB 1.11 trillion, for a year-on-year leap of 36.2%, much higher than market expectation, while imports were RMB 888.16 billion, for a decline of 0.2%. Even though seasonal effects and the yuan's weakness last month likely distorted the data, buyers for China's exports, from industrial metals to consumer electronics and clothing, are not in short supply thanks to a favourable external environment. CPI came at 2.90% year-on-year in February, after a 1.5% rise in the prior month and above market consensus of 2.5%, as cost of food rebounded sharply and cost non-food rose faster. PPI rose 3.7% year-on-year in February, which has increased for 18 consecutive months, slowing from 4.3% in January. Last but not least, China's retail trade increased by 9.7% from a year earlier in January-February of 2018, following a 9.4% rise in December. The acceleration largely resulted from higher auto and home appliances sales.

The Nikkei Hong Kong Manufacturing PMI increased to 51.7 in February 18 from 51.1 in January 18, with growth rates hitting four-year highs. The positive start to 2018 for Hong Kong's private sector extended into February, while a side effect was seen in the labor market as firms revealed efforts to cut costs. Besides, the seasonal adjusted unemployment rate came at 2.9% in February 18, flat with that in January 18. Foreign exchange reserves in Hong Kong increased to USD 443,500 million in February from USD 441,500 million in January.

Taiwan's economic data continued to show positive signals. The manufacturing sector in Taiwan dropped to a 56.0 reading in February, but still above the boom-or-bust line of 50. The latest PMI release pointed to further solid growth of Taiwan's manufacturing sector in February, despite the rate of expansion easing slightly since the start of the year. Taiwan's CPI came in at 2.19% year-on-year in February, higher than January's 0.89%. Moreover, Taiwan's exports dropped 1.2% year-on-year in February, mainly because the Lunar New Year reduced the number of working days that month. We believe that Taiwan's exports would continue to benefit from a better world economy this year and the development of emerging businesses such as artificial intelligence, the Internet of Things and high-performance computing. On the other hand, Taiwan's imports increased by 0.90% year-on-year in February, much lower than 23.3% year-on-year in January. Besides, consumer prices in Taiwan increased 2.19% year-on-year in February, following a marginally revised 0.89% gain in the previous month.

As at 23 March 2018, the CSI 300 Index is currently trading at estimated PE ratios of 13.0X and 11.2X based on estimated earnings in 2018 and 2019 respectively, a discount to its fair value of 15.0X, while the HSML100 Index is trading at 9.7X and 8.5X (based on estimated earnings in 2018 and 2019 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 11.8X and 10.6X based on estimated earnings in 2018 and 2019 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 13.9X and 13.1X based on 2018 and 2019 earnings estimated respectively, slightly lower than our fair PE ratio of 14.0X. We thus maintain a **4.0 Stars "Very Attractive" rating for Taiwan**.

RECOMMENDED FUND:
CIMB-PRINCIPAL GREATER CHINA EQUITY FUND

China (4.5 Stars – Very Attractive)
China A – 3.5 STARS (Attractive)

Why we like it

1. China's two sessions 2018 lays out country's goal
   - China premier Li Keqiang gave an annual "work report" on March 5 in lianghui, highlighting China's economic goals. The regime's aim to expand China's economy by 6.5% in 2018, the same rate as last year even though China's economy grew by 6.9% last year. The 6.5% growth rate will enable China to achieve relatively full employment. While pollution-fighting efforts and a cooling property market weighted on Chinese manufactures, we are still confident that the economic goals will be achieved considering China's solid fundamentals.

2. Economic stabilisation
   - China's industrial production growth seems to gain momentum in the first quarter of 2018, as production rebounded for mining and increased at a faster pace for manufacturing. Besides, both CPI and PPI maintained their upward trend in February. China's consumer prices rose by 2.9% year-on-year in February of 2018, after a 1.5% rise in the prior month. PPI rose 3.70% year-on-year in February, which has increased for 18 consecutive months. Overall, the economy still remains stable, and the rebound in the economy will increase the profitability and earning of corporates and consequently benefit the market.

3. Inclusion of A-shares in the MSCI emerging markets
   - 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 Chinese equities over the next five years. Furthermore, the event may well will 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 favourable environment. Valuations remain attractive. According to market consensus, as at 23 March 2018, the HSML100 Index is trading at 9.7X and 8.5X (based on estimated earnings in 2018 and 2019 respectively) as compared to our fair PE of 13.0X, while the CSI 300 Index is currently trading at estimated PE ratios of 13.0X and 11.2X based on estimated earnings in 2018 and 2019 respectively, a discount to its fair value of 15.0X.

What we don't like

1. External uncertainty
   - After Donald Trump became the 45th US president last year, the trade relationship between the US and China is under threat. The US escalated trade tensions with China in March, involving intellectual property and raising practical barriers for acquisition. Trump's preferences for trade protectionism and anti-globalisation have brought about uncertainty and serious concerns globally.

2. Fed interest rate hike

   - The US Federal Reserve decided to hike federal funds rate target range by a quarter point to 1.5% - 1.75%. The rate hike will likely cause a ripple effect on the borrowing costs for consumers and businesses that want to access credit. Besides, the Fed is expected to raise interest rate two more times this year, which may well put downside pressure on RMB.