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ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

Hong Kong Stock Market Weekly Review

May 31, 2024

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31/5/2024

- **Since 2Q24, Secondary Market for Hong Kong Stocks Improves, but Primary Market Remains Sluggish**
- **Profit Trends in the Top 10 Most Profitable Sub-industries of the Manufacturing Industry**
- **Accelerating Electrification of the Economy – A Boon for the Power Industry**
- **Economic Outlook for Major Developed Economies in 2Q24 Outperforms 1Q24**
- **Fed's Focus on Price Inflation Trends in Personal Consumption Expenditures (PCE)**

1. Since 2Q24, Secondary Market for Hong Kong Stocks Improves, but Primary Market Remains Sluggish

In May, the HSI reached a new high for the year at 19,706 points on May 20. Based on current market expectations for 2024 earnings, this high corresponds to a 2024 PE ratio of ~9.8 times. The index closed the month up 1.8% MoM. Since end-1Q24, the HSI has risen by a cumulative 9.3%. In 5M24, HSI increased by 6.1% YTD.

From Apr to May (the first two months of 2Q), HSI fluctuated between 16,044 and 19,706 points, corresponding to a 2024 PE ratio range of ~8.0 to 9.8 times. In 5M24, the index traded within a range of 14,794 to 19,706 points, corresponding to a 2024 PE ratio range of ~7.7 to 9.8 times. The trading range of the HSI indicates that investors generally expect a reasonable PE ratio range for the index to be ~8 to 10 times, with a midpoint of ~9 times (equivalent to ~18,100 points).

In 5M24, most large-cap companies released their 2023 results and 1Q24 earnings. This increased transparency has helped reduce overly pessimistic or overly optimistic expectations about listed companies' earnings prospects. Consequently, the PE valuation of the HSI hovers around the high single digits, though this valuation range is still below the five-year average of ~11 times. If large-cap companies perform well financially in 2Q24 and 3Q24, the valuation is expected to return to historical average levels.

In terms of asset allocation, in 5M24, the best-performing sectors in the Hong Kong and A-share markets were energy and raw materials, which are sensitive to economic cycles. Conversely, the worst-performing sectors were those related to essentials, such as healthcare and consumer staples. This indicates that investors generally have a positive outlook on the Chinese economy, leading to increased asset allocation in cyclically sensitive sectors and reduced allocation in defensive sectors.

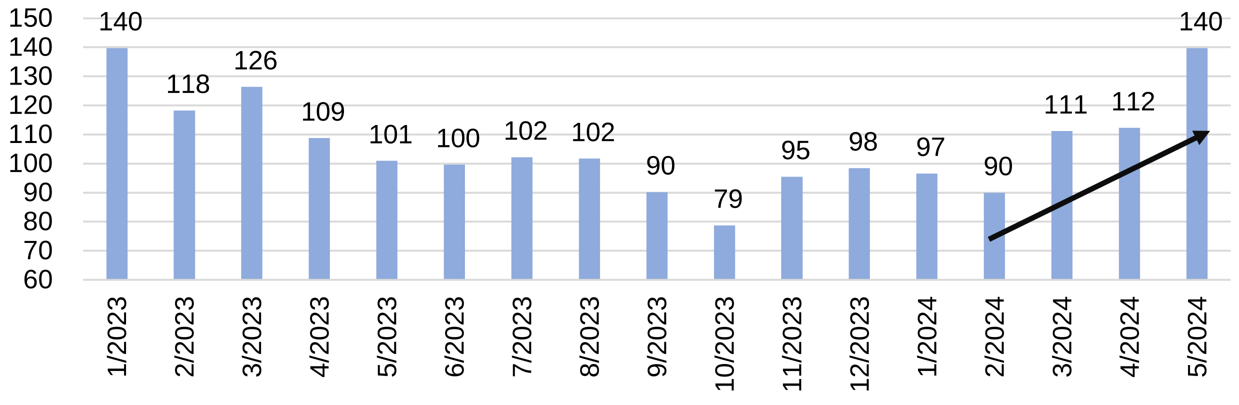
In May, the primary market showed some improvement but remained sluggish. Although the number of IPO companies increased from three in Apr to six in May, IPO fundraising decreased from HK$ 3.1bn in Apr to HK$ 1.7bn in May. The average fundraising per IPO in May was less than HK$ 300mn. In 5M24, a total of 21 IPO companies were listed, raising ~HK$ 9.6bn, with an average fundraising of ~HK$ 460mn per IPO. In 5M23, a total of 25 IPO companies were listed, raising ~HK$ 15.8bn, with an average fundraising of ~HK$ 630mn per IPO.

Exhibit 1: 1-5/2024 Regional Index Performance*

	Hang Seng Composite Index	CSI 300 Index	MSCI Asia Pacific Index	MSCI Europe Index	S&P 500 Index
Benchmark index	**5.8%**	**4.3%**	**4.3%**	**7.8%**	**9.8%**
Energy	43.5%	28.1%	10.1%	5.3%	7.9%
Materials	37.3%	14.6%	-8.2%	4.9%	5.5%
Telecom	14.6%	7.3%	6.7%	5.8%	19.7%
I.T.	11.4%	-7.8%	8.4%	15.6%	16.9%
Utilities	8.8%	19.3%	11.8%	-3.9%	12.3%
Financials	7.7%	9.1%	8.5%	12.1%	8.8%
Industrials	7.3%	5.4%	7.1%	11.8%	6.9%
Consumer discretionary	-3.8%	9.2%	3.5%	5.6%	0.2%
Consumer staples	-7.7%	-0.3%	-4.9%	-1.4%	6.6%
Real estate	-8.0%	-8.1%	-4.7%	0.4%	-7.1%
Healthcare	-24.3%	-15.0%	-6.5%	9.5%	3.6%

Note*：A-share and HK stock markets are up to May 31; MSCI Indexes and S&P500 Index are up to May 30.
Source(s): Bloomberg, ABCI Securities

Exhibit 2: HK Mainboard Average Daily Turnover (HK$bn/day)



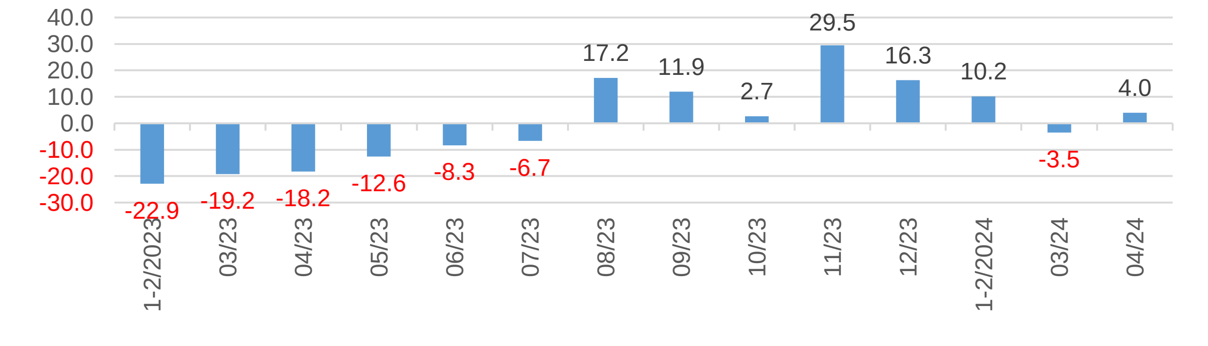
Source(s)：Bloomberg, HKEx, ABCI Securities

2. Profit Trends in the Top 10 Most Profitable Sub-industries of the Manufacturing Industry

At end-May, investors are focusing on the profit prospects of industrial enterprises for the 2Q24. The NBSC has released the monthly survey on the financial operations of national-scale industrial enterprises for 4M24, which will provide in-depth insights into the financial performance of major industries in the 2Q24. By comparing previous surveys, we can understand the profit growth momentum of major industries in Apr.

The total profit of industrial enterprises in Apr was up 4.0% YoY, compared to a decline of 3.5% YoY in Mar. The profit for 4M24 increased by 4.3% YoY, and the profit for 3M24 also increased by 4.3% YoY. One might wonder why the profit growth rate for Apr is lower than 4.3%, given that the profit growth rates for 4M24 and the 3M24 are the same. The main reason is that the growth rate in the survey report represents the comparable YoY growth rate, rather than the YoY change in absolute values between two different periods.

Exhibit 3: Total Profits of Industrial Enterprises (Change % YoY)



Remarks: Statistics are based on industrial enterprises with annual revenue over RMB20mn. Total profits refer to the surplus realized by a business after subtracting all costs incurred throughout the production process, reflecting the total profits and losses over the reporting period.

Source(s): NBSC, ABCI Securities

Exhibit 4: Total Profits of Industrial Enterprises

	1-4/2024 Profit RMB100 mn	1-4/2024 Profit Change (%YoY)	1-3/2024 Profit Change (%YoY)	1-4/2023 Profit Change (%YoY)
Total	**20,946.9**	**4.3**	**4.3**	**(20.6)**
Of which：				
Manufacturing	14,439.8	8.0	7.9	(27.0)
Mining	3,923.9	(18.6)	(18.5)	(12.3)
Public Utilities	2,583.2	36.9	40.0	34.1

Source(s): NBSC, ABCI Securities

Among the top 10 sub-industries with the highest profits in the manufacturing industry, “computer, communication equipment and other electronic equipment”, and “manufacture and processing of non-ferrous metals”, and the “motor vehicles” saw their profits increase by ~76% YoY, ~57% YoY, and ~29% YoY, respectively, in 4M24. These three industries ranked first, second, and third in profit growth among the ten most profitable manufacturing sub-industries. Their profit scales ranked second, ninth, and third, respectively.

Exhibit 5: The 10 most profitable sub-industries in manufacturing industry

	1-4/2024 Profit RMB100 mn	1-4/2024 Profit Change (%YoY)	1-3/2024 Profit Change (%YoY)	1-4/2023 Profit Change (%YoY)
Electrical Machinery and Equipment	1,502.5	(4.7)	(6.9)	30.1
Computer, Communication Equipment and Other Electronic Equipment	**1,441.7**	**75.8**	**82.5**	**(53.2)**
Motor Vehicles	**1,427.9**	**29.0**	**32.0**	**2.5**
Chemical Raw Material and Chemical Products	1,234.4	8.4	(3.5)	(57.3)
Medicines	1,114.8	2.3	(2.7)	(23.8)
Wines, Beverages, and Refined Tea	1,016.0	8.7	11.1	11.6
Cigarettes and Tobacco	917.5	3.7	3.7	6.7
General-Purpose Machinery	870.4	6.2	7.9	20.7
Manufacture and Processing of Non-Ferrous Metals	**754.8**	**56.6**	**57.2**	**(55.1)**
Special-Purpose Machinery	654.0	(7.3)	(7.2)	(7.4)

Remarks: Statistics are based on industrial enterprises with annual revenue over RMB 20mn
Source(s): NBSC, ABCI Securities

In 4M23, “computer, communication equipment and other electronic equipment” the “manufacture and processing of non-ferrous metals” saw their profits plummet by ~53% YoY and ~55% YoY, respectively. We believe that the strong profit growth momentum seen in 4M24 is mainly due to the low base effect last year.

In 4M23, profits in automobile manufacturing (as indicated by “motor vehicles”) were up by 2.5% YoY. However, in 4M24, the profit growth rate has accelerated to ~29% YoY, indicating a positive trend in the industry. Nevertheless, the profit growth rate in 1Q24 was ~32% YoY, suggesting that the profit growth rate in Apr slowed down to ~20% YoY.

Among the 10 most profitable manufacturing sub-industries, “electrical machinery and equipment” ranked first in terms of profit scale. However, it saw its profits decline by ~4.7% YoY in 4M24. The decline narrowed by 2.2ppt compared to 1Q24, indicating that the profit decline in Apr was ~2% YoY. This industry saw its profits increase by ~30% YoY in 4M23. Perhaps these statistics serve as a warning signal for the financial performance of solar and battery product manufacturers, as these products are included in the category.

Among the 10 most profitable manufacturing sub-industries, “special-purpose machinery” ranked last in terms of profit scale. Profits declined by ~7.3% YoY in 4M24, similar to the ~7.4%

YoY drop in the same period last year, indicating that the industry's situation remains unchanged. “General-purpose machinery” performed better than “special-purpose machinery”, with the former’s profits increasing by ~6.2% YoY in 4M24, compared to a ~21% YoY increase in 4M23. After high growth last year, the growth rate has slowed down significantly this year. “General-purpose machinery” ranked eighth in terms of profit scale.

Pharmaceutical manufacturing (as indicated by “medicines”) is also among the ten most profitable manufacturing sub-industries, ranking fifth in profit scale. The pharmaceutical manufacturing industry saw its profits increase by ~2.3% YoY in 4M24, but its profits declined by 2.7% YoY in 1Q24, indicating profits surged by ~17% YoY in Apr. The segment saw its profits decline by ~24% YoY in 4M23. The pharmaceutical manufacturing industry's profit fluctuations are significant, reflecting risks.

“Wines, beverage, and refined tea” and the “cigarettes and tobacco” ranked sixth and seventh in the 10 most profitable sub-industries in terms of profit scale. These two manufacturing industries saw their profit growth rates slow down to ~8.7% YoY and ~3.7% YoY, respectively, in 4M24, compared to ~11.6% YoY and ~6.7% YoY, in 4M23.

Exhibit 6：Mining and Public Utility industries

	1-4/2024 Profit RMB100 mn	1-4/2024 Profit Change (%YoY)	1-3/2024 Profit Change (%YoY)	1-4/2023 Profit Change (%YoY)
Top 5 in Mining industry :				
Mining and Washing of Coal	1,998.9	(34.2)	(33.5)	(14.6)
Extraction of Petroleum and Natural Gas	1,358.9	4.3	3.8	(6.0)
Mining of Non-Ferrous Metal Ores	251.3	1.6	(14.9)	6.7
Mining of Ferrous Metal Ores	212.5	64.2	103.8	(42.8)
Mining and Processing of Non-metal Ores	99.2	(4.6)	1.8	10.8
Top 3 in Public Utility industry :				
Production and Supply of Electric Power and Heat Power	2,197.4	44.1	47.5	47.2
Production and Distribution of Gas	268.4	(0.4)	(2.0)	(4.7)
Production and Distribution of Water	117.4	26.0	42.0	5.8

Remark: Statistics are based on industrial enterprises with annual revenue over RMB 20mn

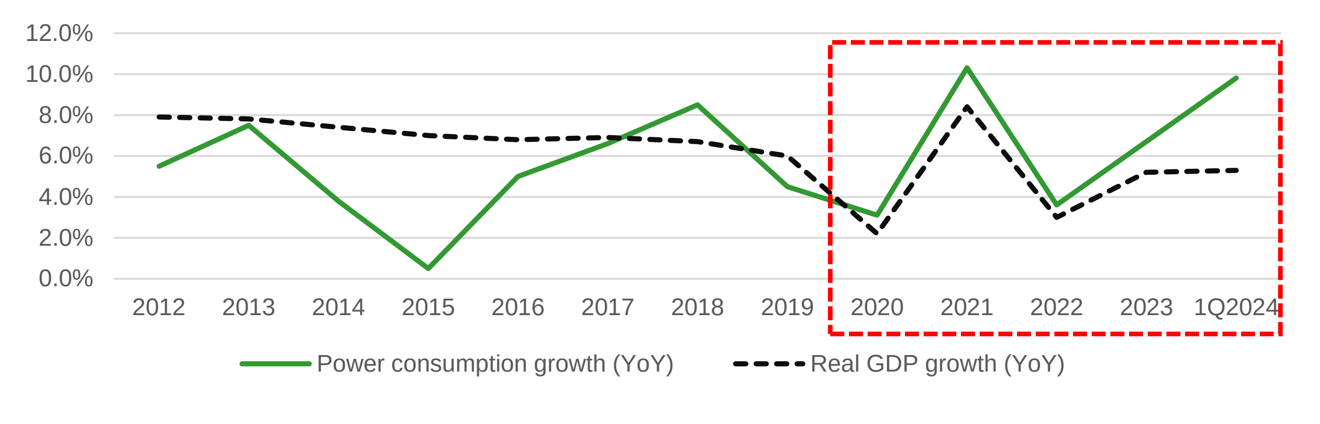
Source(ss): NBSC, ABCI Securities

3. Accelerating Electrification of the Economy – A Boon for the Power Industry

The power industry has been a highlight in the utility sector for industrial enterprises in 2023 and 2024. According to the NBSC, the total profits of the electricity and thermal power production and supply industry increased by 71.9% YoY in 2023 and by 44.1% YoY in 4M24.

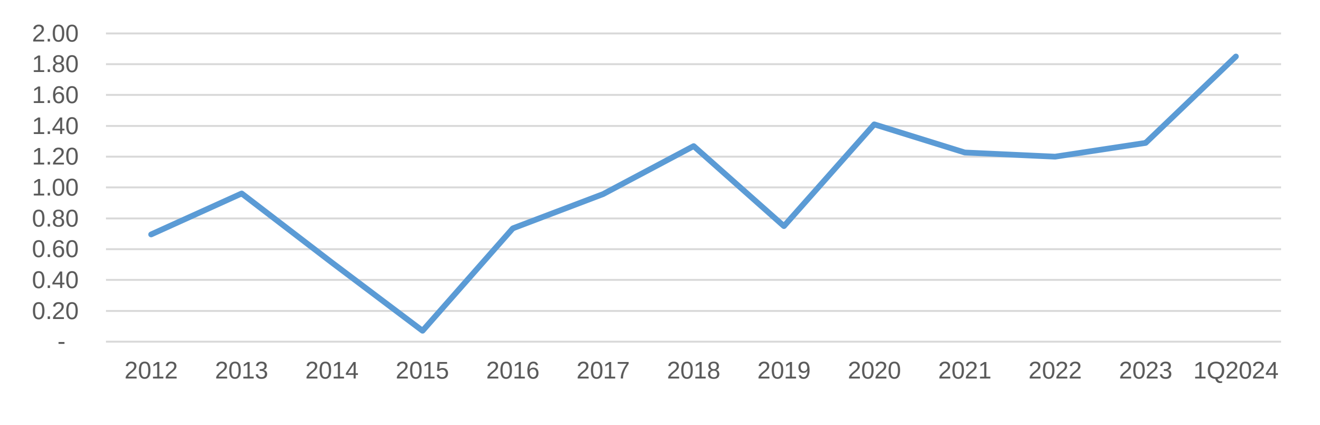
Recently, a notable macro and microeconomic trend has caught our attention. Before 2020, the real economy's growth rate was higher than the growth rate of electricity consumption in most years. However, after 2019, this trend has reversed. Since 2020, electricity consumption growth has exceeded real GDP growth. In 1Q24, national electricity consumption increased by 9.8% YoY, surpassing the real GDP growth rate of 5.3% by 4.5ppt. In 2023, total electricity consumption grew by 6.7% YoY, exceeding the real GDP growth rate by 1.5ppt. Since 2023, the gap between the growth rates of electricity consumption and real GDP has been widening. If this trend continues, it will benefit the power generation industry. Power generation is a capital-intensive industry with high fixed costs. The industry's profitability is sensitive to demand growth; faster demand growth will lead to better asset utilization.

Exhibit 7: Power consumption growth vs. real GDP growth
During 2020-1Q24, power consumption growth outpaced real GDP growth



Source(s): NEA, NBSC, ABCI Securities

Exhibit 8: Power demand ratio = Power consumption growth/Real GDP growth



Source(s): NEA, NBSC, ABCI Securities

Some may be concerned that while the economy consumes more electricity, the production doesn't increase proportionately, potentially causing this phenomenon. We attribute this to the government's proactive promotion of green economic development. Why has electricity consumption growth surpassed real economic growth in recent years?

On the supply side, we notice that the surge in solar, wind, and nuclear power installations has contributed to the rise in green electricity supply. In 1Q24, national power generation capacity increased by 14.5%YoY, with solar and wind power up by 55.0% and 21.5%, respectively. In 2023, national power generation capacity rose by 13.9% YoY, with solar and wind power increasing by 55.2% and 20.7%, respectively.

On the demand side, the widespread adoption of new energy vehicles (NEVs) and the expansion of the electrified railway network have boosted electricity demand in transportation. In the metal smelting industry, electric boilers have replaced fossil fuel-burning ones to curb carbon emissions. Manufacturing firms have upped the use of green electricity in their facilities to enhance their ESG ratings. In northern regions, electric-based home heating is replacing fossil fuel-based heating.

All these changes in supply and demand can lead to a reduced reliance on fossil fuel energy consumption for economic growth, while increasing dependence on electricity, especially green electricity. The decrease in reliance on fossil fuel energy consumption has led to a decline in coal prices since 2023, which benefits the profitability of the thermal power industry.

The power generation sector is benefiting from this trend. According to data from the NBSC, the total profits of the electricity and heat production and supply industry increased by 86.3%, 71.9%, and 44.1% YoY in the first four months of 2022, 2023, and 2024, respectively.

4. Economic Outlook for Major Developed Economies in 2Q24 Outperforms 1Q24

Since 2024, major developed economies such as the US, the Eurozone, the UK, and Japan have witnessed a consistent improvement in their composite output PMI. Based on the composite output PMI for Apr and May, the economic outlook for 2Q24 may surpass that of 1Q24. The quarterly average of the composite output PMI for the US, the Eurozone, the UK, and Japan is on an upward trend, with Apr-May averages suggesting a potential increase in 2Q24 compared to 1Q24. Particularly notable is the Eurozone's composite output PMI, which, after three consecutive quarters of contraction since 3Q23, may return to expansion territory in 2Q24.

Exhibit 9：PMI Composite Output Index（period average）

	U.S.	Japan	Eurozone	UK
4-5/2024	52.9	52.4	52.0	53.5
1Q 2024	52.2	51.3	49.1	52.9
4Q 2023	50.8	50.0	47.2	50.5
3Q 2023	50.8	52.3	47.5	49.3
2Q 2023	53.6	53.1	52.3	53.9
1Q 2023	49.7	51.6	52.0	51.3

Remarks: May 2024 PMI figures are preliminary. Our focus is on the trend of PMI.

Source(s): S&P Global, ABCI Securities

Manufacturing activity in the US market has transitioned from contraction to steady expansion since last year, while the Japanese and UK markets are showing early signs of expansion in 2Q24. In the Eurozone, the pace of contraction slowed down in 1Q24, and further easing may occur in 2Q24. The ongoing improvement in manufacturing activity positively impacts global trade recovery and contributes to the rise in industrial metal prices this year.

Exhibit 10：Manufacturing PMI（period average）

	US	Japan	Eurozone	UK
4-5/2024	50.5	50.1	46.6	50.2
1Q 2024	51.6	47.8	46.4	48.3
4Q 2023	49.1	48.3	43.9	46.1
3Q 2023	48.9	49.2	43.2	44.2
2Q 2023	48.3	50.0	44.7	47.1
1Q 2023	47.8	48.6	48.2	48.1

Remark: May 2024 PMI figures are preliminary. Our focus is on the trend of PMI.

Source(s): S&P Global, ABCI Securities

The expansion of the service sector has been a key support for major developed economies. Since 2024, there has been a faster pace of growth in service sector activity. Based on the services PMI for Apr and May, 2Q24 outlook for the service sector is expected to surpass that of 1Q24. The ongoing expansion in the service sector will exert inflationary pressure on service prices, influencing central bank monetary policy decisions by counteracting the downward trend in inflation rates.

Exhibit 11: Services PMI (period average)

	U.S.	Japan	Eurozone	UK
4-5/2024	53.1	54.0	53.3	54.0
1Q 2024	52.2	53.4	50.0	53.7
4Q 2023	50.9	51.3	48.4	51.3
3Q 2023	51.0	54.0	49.2	50.1
2Q 2023	54.3	55.1	54.4	54.9
1Q 2023	50.0	53.8	52.8	51.7

Remark: May 2024 PMI figures are preliminary. Our focus is on the trend of PMI.

Source(s): S&P Global, ABCI Securities

Based on the trends in manufacturing and services PMI, developed economies face challenges on the supply side. The supply-side expansion may not keep up with the demand-side growth. Consequently, we have seen significant rebounds in international shipping rates, major industrial metal prices, and crude oil prices since the beginning of 2024.

Exhibit 12: Eurozone PMI Trend

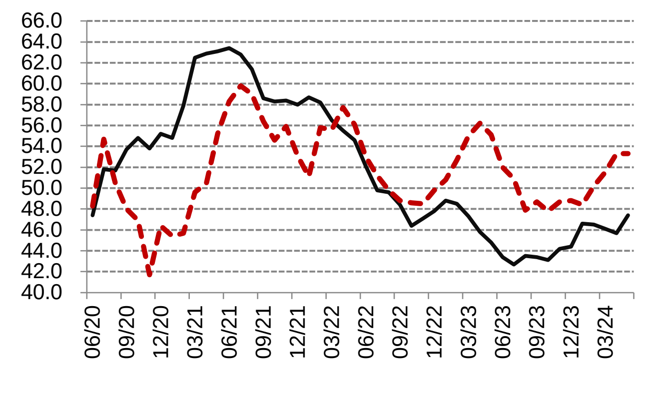
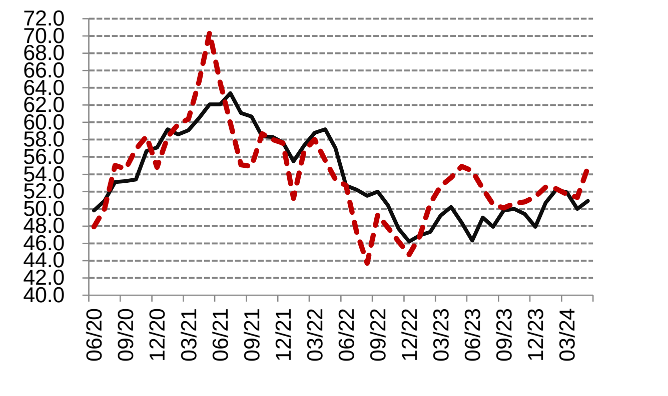


Exhibit 13: US PMI Trend



Black line: Manufacturing PMI; Red dot line: Services PMI

Source(s) : S&P Global, ABCI Securities

Exhibit 14: UK PMI Trend

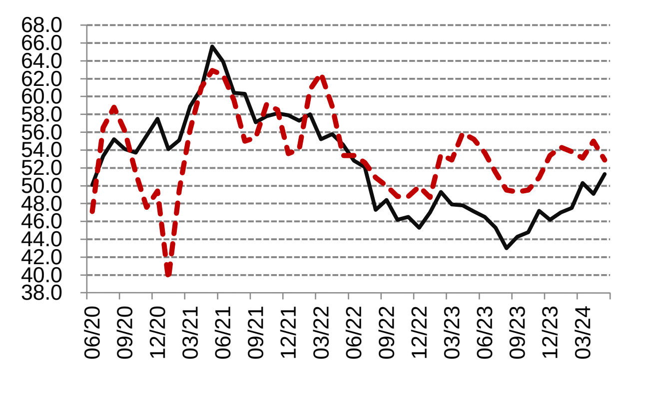
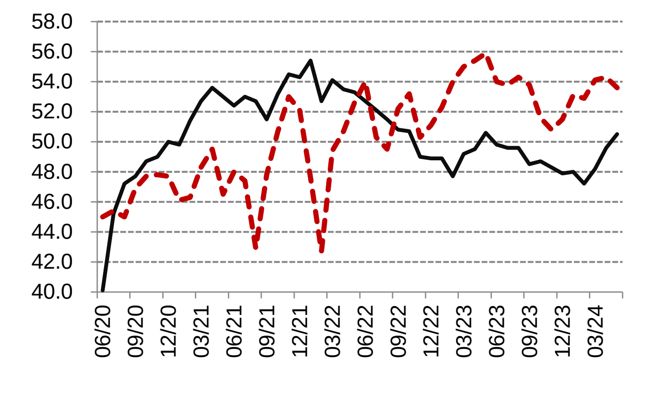


Exhibit 15: Japan PMI Trend



Black line: Manufacturing PMI; Red dot line: Services PMI

Source(s) : S&P Global, ABCI Securities

5. Fed's Focus on Price Inflation Trends in Personal Consumption Expenditures (PCE)

On May 31 (US time), the Apr PCE price inflation rate will be released. There are various indicators used to measure economic inflation pressure, such as CPI, PPI, and PCE, but the PCE price inflation indicator is the primary focus for the Fed in assessing inflation pressures and trends. Typically, CPI inflation is released one to two weeks earlier than PCE inflation. Moreover, the government departments that survey CPI and PCE are different. Although the inflation data represented by CPI and PCE can differ, our analysis indicates that they exhibit similar directional trends and have a strong statistical correlation. Since CPI is usually released before PCE, CPI serves as a leading indicator for PCE.

From mid-2022 to the end of 2023, PCE price inflation showed a downtrend, with inflation pressures continuously easing. Consequently, the market previously expected the Fed to significantly cut interest rates starting in 2024. However, since the beginning of 2024, the rate of decline in PCE has been slowing. Therefore, the market now expects that the Fed will not rush to cut interest rates. Interest rate outlooks influence investment decisions and financial asset valuations. It is necessary for us to understand why the rate of decline in PCE inflation has slowed since 2024.

Exhibit 16: PCE Price Inflation (%YoY)

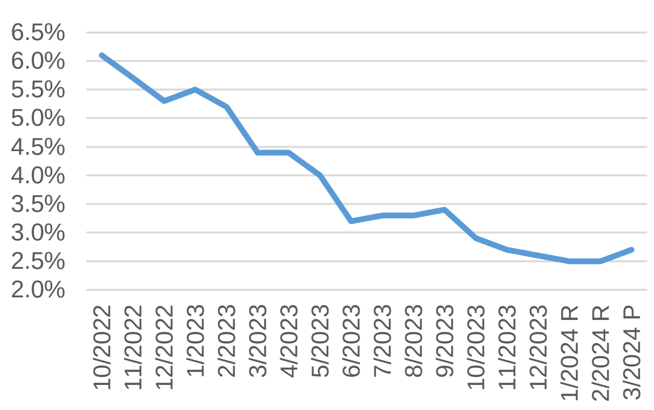
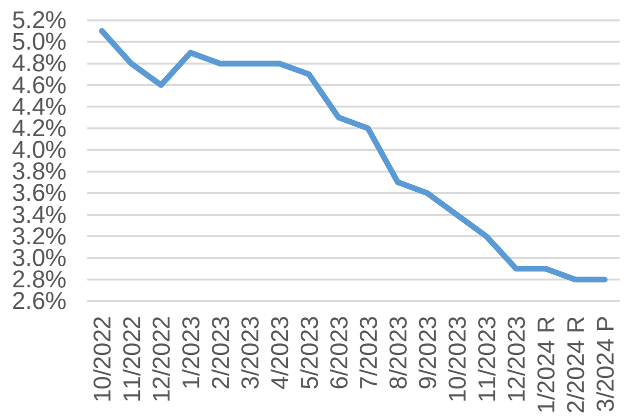


Exhibit 17: Core PCE Price Inflation (%YoY)



P: Preliminary; R: Revised
Source(s) : US Bureau of Economic Analysis, ABCI Securities

Our analysis indicates that two factors are hindering the decline in PCE inflation. Firstly, PCE services inflation remains high and has been declining slowly. We believe that strong services and personal income or wage growth have led to high PCE services inflation. Secondly, the rise in crude oil prices from 2024 to date has increased the upward pressure on PCE energy inflation. Thirdly, PCE goods and food inflation pressures remain relatively low. Therefore, services inflation and energy inflation are the primary factors influencing PCE inflation. The US services PMI shows that the services sector is performing strongly, making it difficult for PCE services inflation to ease quickly. Due to the low base effect last year, energy inflation pressure may increase in May and Jun. However, the high base effect in Sep and Oct 2023 may lead to a slowdown in PCE energy inflation in Sep and Oct 2024.

Is PCE inflation data significantly higher than the Fed's target? The answer is no. In Mar, PCE and core PCE inflation rates were ~2.7% YoY and ~2.8% YoY, respectively. The Fed previously expected PCE and core PCE inflation rates to decline to ~2.4% YoY and ~2.6% YoY, respectively, in the 4Q24. However, the Fed is more concerned with the inflation trend rather than the single-month inflation rate. Due to the high services inflation pressure and energy inflation rebound since 2024, the Fed is hesitant to cut interest rates.

Exhibit 18: PCE Inflation (main items, YoY)

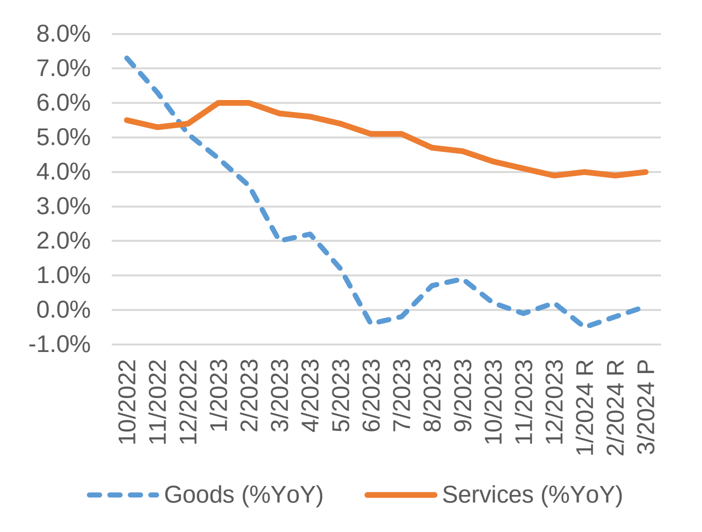
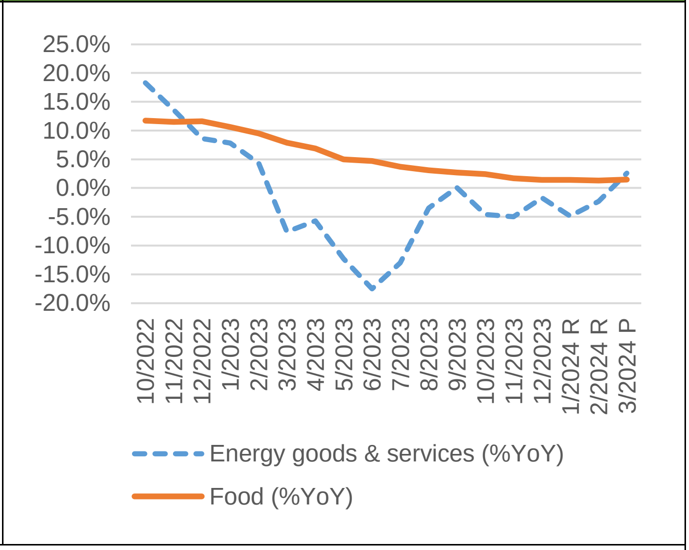


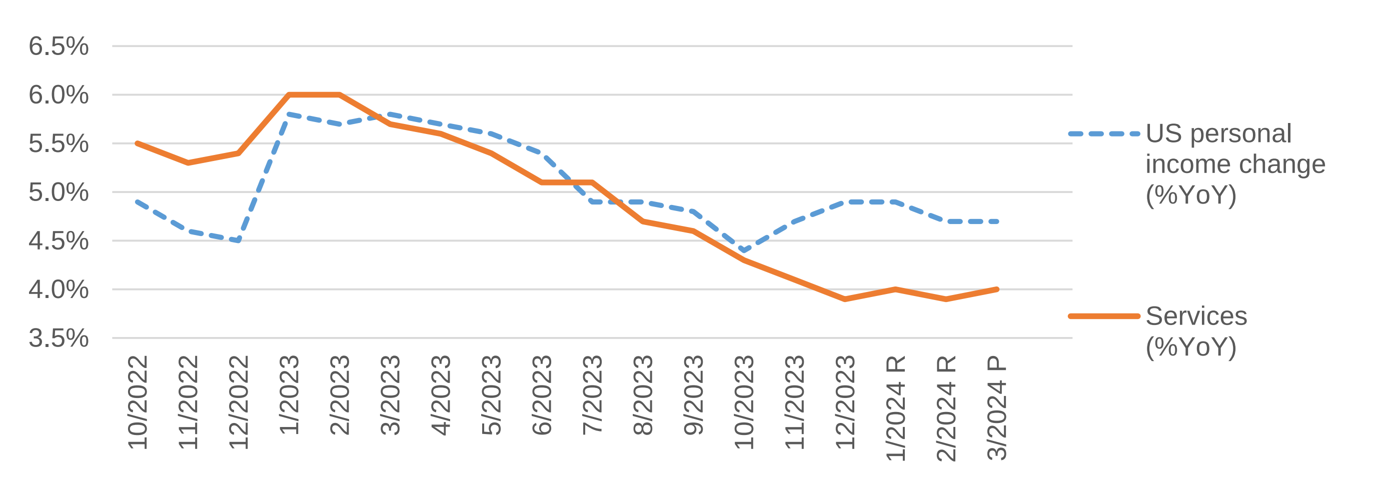
Exhibit 19: PCE Inflation (main items, YoY)



P: Preliminary; R: Revised

Source(s)：U.S. Bureau of Economic Analysis, ABCI Securities

Exhibit 20: PCE Services Inflation vs Personal Income (YoY)



P: Preliminary; R: Revised

Source(s)：US Bureau of Economic Analysis, ABCI Securities

Disclosures

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Definition of equity rating

Rating	Definition
Buy	Stock return rate≥ Market return rate (~7%)
Hold	- Market return rate (~-7%) ≤ Stock return rate < Market return rate (~+7%)
Sell	Stock return < - Market return (~-7%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2005 (For reference: 2005-23 HSI total return index averaged at 7.4%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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