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ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

Hong Kong Stock Market Weekly Review

Jul 12, 2024

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12/7/2024

- **US-China Inflation Data Guide Market Expectations for Rate Cuts**
- **Increasing Complexity in the External Political and Economic Environment Reduces Predictive Accuracy**
- **Tesla's Financial Data Highlights Market Demand and Focus on NEVs**
- **Large Real Estate Companies Show Continuous MoM improvement in Sales Performance**

1. US-China Inflation Data Guide Market Expectations for Rate Cuts

This week, China and the US, the world's two largest economies, released their CPI inflation data. In China, the Jun inflation data revealed that both the CPI and core CPI have decreased MoM for the second consecutive month, indicating persistent deflationary pressures. Specifically, the overall CPI fell by ~0.1% MoM in May and by ~0.2% MoM in Jun. The core CPI decreased by ~0.2% MoM in May and by ~0.1% MoM in Jun. YoY, the CPI and core CPI for Jun increased by 0.2% and 0.6% YoY, respectively. In 1H24, the CPI and core CPI rose YoY by 0.1% and 0.7%, respectively. These figures are interpreted by the market as a sign of ongoing weak consumer demand, leading economists to predict that the PBOC might need to cut interest rates in 2H to stimulate demand.

In the US, the CPI for Jun decreased by ~0.1% MoM, marking the lowest level since Jun 2020 and the first MoM decrease since that month. The core CPI rose by ~0.1% MoM, with the rate of increase contracting for the third consecutive month. The interest rate futures market reacted accordingly. After the release of the CPI data, the likelihood of the Fed cutting rates in Sep rose to about 90%. At the beginning of Jul, the market estimated a 60% chance of a rate cut in Sep.

From an investor's perspective, the likelihood of the Fed cutting rates in Sep increasing to ~90% suggests that the anticipated Fed actions are nearly fully priced into asset prices. This means that stocks, bonds, and other assets have already largely adjusted to reflect these expectations. For example, since the release of the CPI data for May and Jun, the yields on 1-year and 2-year US Treasury bonds have decreased by about 27bps and 35bps, respectively. This movement in bond yields or prices indicates the market has already accounted for the possibility of at least one rate cut.

However, market expectations are prone to rapid changes. In Mar, the chance of a Sep rate cut was estimated at ~90%, but by Apr, these expectations shifted dramatically, with the likelihood dropping to ~30%. This week, the probability has again risen to ~90%. Such significant fluctuations are typically triggered by the release of monthly inflation data, which causes continuous adjustments in market forecasts. Therefore, the inflation data for Jul and Aug, to be released before the Fed's rate decision meeting on Sep 18, will be crucial in shaping market expectations regarding future interest rate movements.

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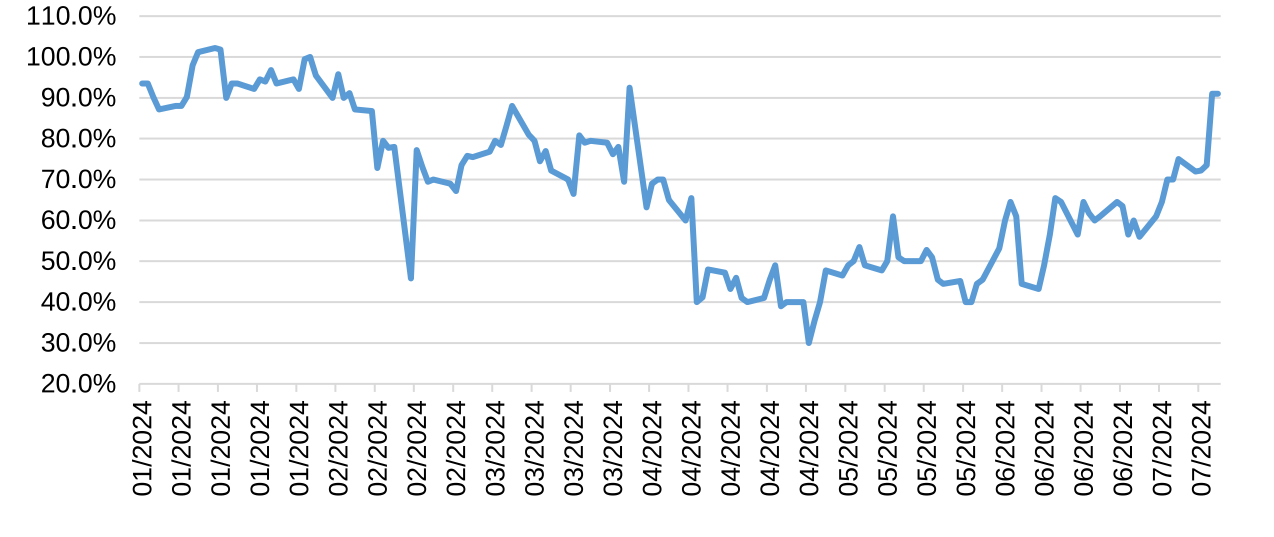
This week, the HSI experienced a rebound, driven primarily by several key factors. Industry surveys showed a revival in the personal computer market, and reports indicated that Apple (AAPL US) has increased its sales forecasts for this year's new iPhone models. Additionally, news that Microsoft (MSFT US) will discontinue updates for Windows 10 this year is likely to prompt businesses to upgrade their PCs. The market expects that the launch of AI-powered computers and smartphones will stimulate demand in the consumer electronics sector, leading to gains in Chinese chip and electronics stocks. Essentially, technological innovations are driving supply-side reforms, creating new or replacement demand for electronics products. Industry reports also highlighted that sales of NEVs in China saw significant growth both YoY and MoM in Jun. Along with a rebound in Tesla (TSLA US)'s stock since early Jul, this has propelled Chinese NEV stocks upward. The rising expectation of US interest rate cuts has also led to a recovery in Hong Kong real estate stocks from their lows. In contrast, Chinese energy and power stocks, which had been performing well, declined this week as some investors took profits and shifted to previously lagging stocks. This week, the rise in electronics and NEV stocks helped the HSTECH Index climb, outperforming HSI. HSTECH Index increased by ~5.2% while HSI gained ~2.8%.

Exhibit 1: Interest Rate Futures Market reflects implied probability of the Fed's cutting interest rate in Sep 2024



Source(s): Bloomberg, ABCI Securities

2. Increasing Complexity in the External Political and Economic Environment Reduces Predictive Accuracy

In recent weeks, the external political and economic landscape has become significantly more complex. Firstly, recent political shifts in the EU, the UK, and France may affect trade ties with China and transform the broader politico-economic environment. From Jan to May, measured in US dollars, China's trade with the EU, the UK, and France accounted for approximately ~12.7%, ~1.5%, and ~1.3% of China's total export and import value, respectively. These regions contributed to about ~28.3%, ~6.7%, and ~1.0% of China's goods trade surplus. During 5M23, the trade surplus with the EU and the UK represented nearly ~35% of China's overall trade surplus.

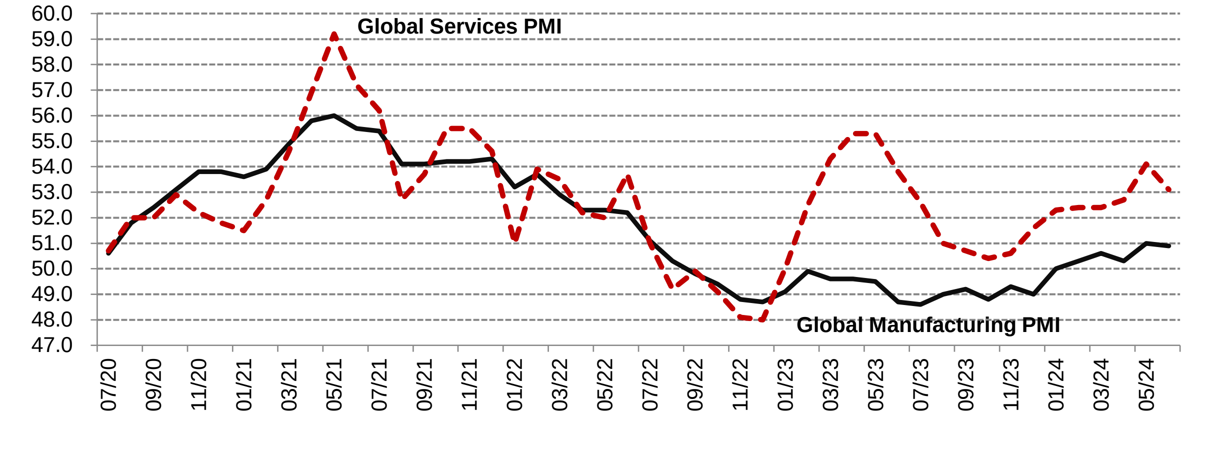
Secondly, the US presidential election in Nov might bring about significant political shifts if there is a change in the ruling party. Such changes could lead to new leadership in key economic departments, such as the Treasury and the Department of Commerce, potentially setting off a series of reactions due to shifts in the political and economic environment. Western media have reported that US fund managers have recently been busy adjusting their investment portfolios in preparation for the potential election of Donald Trump. His preference for protectionism and fiscal expansion could exacerbate trade disputes between the US and China and lead to a resurgence of inflation in the US. As a result, there might be a need to reevaluate the current market expectations concerning the interest rate cycle in the US and prepare for potential risks. From Jan to May, measured in USD, China's trade in goods with the US accounted for ~10.7% of its total imports and exports, with China's trade surplus with the US comprising nearly 38% of its overall surplus.

Thirdly, political changes in Europe and the US are introducing new variables into the geopolitical risks associated with regions such as the Middle East and the Russia-Ukraine conflict.

Fourthly, in 5M23, China's actual utilization of foreign investment decreased by 28.2% YoY. Within this, the manufacturing sector accounted for 28% of the actual foreign investment utilized, and high-tech manufacturing constituted 43% of the investment in the manufacturing sector. This reflects a stronger interest in non-manufacturing and high-tech manufacturing investments by foreign investors, but a lower inclination to invest in general manufacturing due to competitive disadvantages. We believe foreign investors will base their investment decisions on their evaluation of market opportunities in China and their own competitive strengths.

Fifthly, the economic data from 1H23 has not yet reflected the recent political changes in the EU, the UK, and France, nor the increased market uncertainty regarding the US presidential election. During 1H23, the global PMI indicated that economic activities in both the manufacturing and service sectors continued to expand, suggesting a steady recovery in the global economy.

Exhibit 2: Global PMI



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

3. Tesla's Financial Data Highlights Market Demand and Focus on NEVs

On Jul 2, Tesla released its vehicle delivery statistics for 2Q24, leading to an increase in its stock price. From the end of Jun to Jul 9, Tesla's stock has risen nearly 33%. The company is scheduled to announce its 2Q24 financial results on Jul 23, US time. With a substantial increase in its stock price since the start of Jul, the market appears optimistic about Tesla's upcoming quarterly performance.

Tesla disclosed that its 2Q24 production totaled ~411k vehicles, while deliveries reached ~444k vehicles. In comparison, 1Q saw a production of ~433k vehicles and deliveries of ~387k vehicles. This represents a ~5% decrease in production and a ~15% increase in deliveries from 1Q24 to 2Q24. The fact that deliveries surpassed production in 2Q24 suggests a reduction in inventory levels from 1Q24, which positively contributed to the cash inflow during 2Q24

In its 1Q24 financial report, Tesla revealed several data points that worried the investment market, which explains the stock's poor performance in Apr. One primary concern was the rising vehicle inventory cycles. In 1Q24, Tesla's global vehicle inventory increased to 28 days. However, throughout 2023, inventory levels were consistently maintained at ~15-16 days each quarter. The rise in inventory levels raised concerns among investors that a sales slowdown might force Tesla to reduce its prices to stimulate sales. From this perspective, an inventory cycle of about half a month is considered reasonable for the company, but an increase to nearly a month indicates a slowdown in sales. Automotive manufacturers maintaining stable and short inventory cycles enhance cash management and prevent excessive cash from being tied up in finished but unsold vehicles.

Free cash flow is another critical focus area. Free cash flow is the cash available after deducting capital expenditures from the cash generated by operating activities. Essentially, it reflects the extra financial resources a company has for new developments. In 1Q24, Tesla's free cash flow was negative US$ 2.53bn; however, throughout 2023, the free cash flow ranged from a positive US$ 440mn to US$ 2.06bn each quarter. The primary reason for the negative free cash flow in 1Q24 was the significant drop in cash generated from operating activities, despite an increase in capital expenditures.

A substantial increase in inventory can tie up cash, leading to a reduction in the cash flow from operations and a consequent decrease in free cash flow. Some professional investors use free cash flow trends to assess a company's valuation trend. However, not all publicly traded companies consistently disclose their quarterly free cash flow to investors. Particularly, when a company reports negative free cash flow, it can lead to a negative market reaction.

Li Auto (2015 HK) reported on May 20 that its free cash flow for 1Q24 was a negative RMB 5.1bn. In contrast, 1Q23 showed a positive free cash flow of RMB 6.7bn, and 4Q23 was positive RMB 14.6 bn. Between May and Jun, its stock price showed a negative reaction. Both Tesla and Li Auto had negative free cash flows in 1Q24, which negatively impacted their stock prices.

Another key metric is the trend in automotive sales gross margins. Although automakers may have diverse revenue sources, their primary income still comes from vehicle sales. Tesla's automotive sales gross margin decreased from 18.3% in 1Q23 to 16.6% in 4Q23, and further to 15.6% in 1Q24. According to this trend, the gross profit per vehicle in 1Q24 was ~US$ 6800 (about RMB 49k), compared to ~US$ 8100 in 1Q23, and ~US$ 7200 in 4Q23. This downward trend is concerning.

In the upcoming Tesla 2Q24 financial report, investors will closely monitor whether the automotive inventory cycle has normalized, whether the free cash flow trend has shifted from negative to positive, and whether the decline in automotive sales gross margins can be reversed.

Exhibit 3: Tesla's Quarterly Average Gross Profit Per Vehicle (thousand USD)

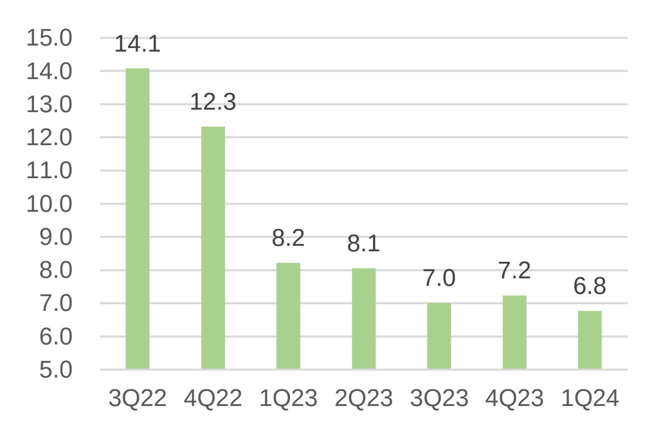
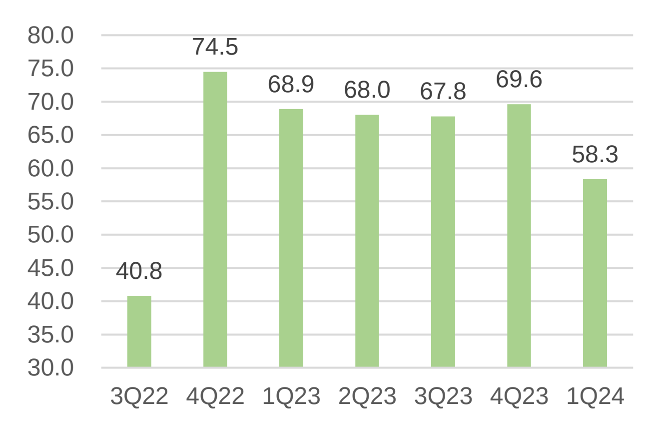


Exhibit 4: Li Auto's Quarterly Average Gross Profit Per Vehicle (thousand RMB)



Source(s):Tesla, Li Auto, ABCI Securities

Exhibit 5: Tesla's Quarterly ASP Per Vehicle (thousand USD) and Automotive Sales Gross Margin

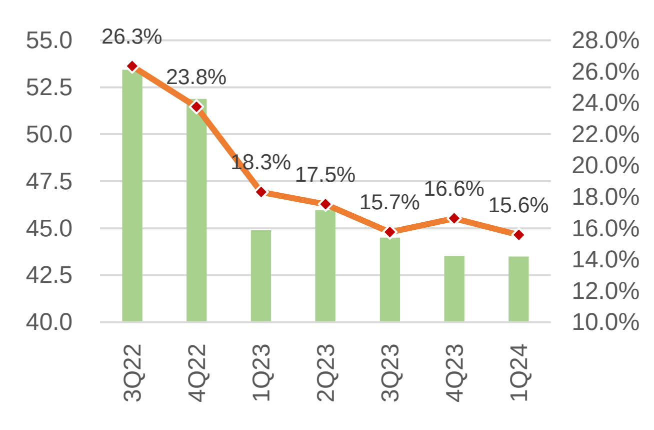
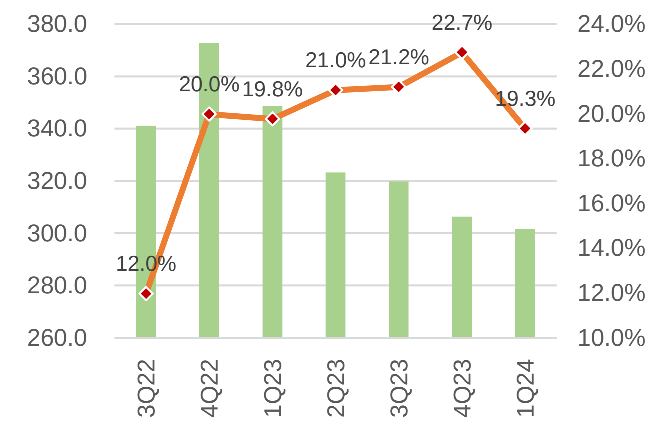


Exhibit 6: Li Auto's Quarterly ASP Per Vehicle (thousand RMB) and Automotive Sales Gross Margin



Source(s): Tesla, Li Auto, ABCI Securities

4. Large Real Estate Companies Show Continuous MoM improvement in Sales Performance

According to the latest monthly sales data from major real estate developers, there is a noticeable trend of continuous MoM improvement in new home sales, which may indicate a resurgence in buyer confidence. Poly Developments (600048 CH), the largest developer in China by contract sales, reported a 75% QoQ increase in contract sales for 2Q24, with a consistent rise in MoM sales for four consecutive months up to Jun. China Overseas Land (688 HK) experienced a 47% QoQ growth in contract sales in 2Q24, with a significant 137% MoM increase in new home contract sales in Jun. Vanke (2202 HK) saw a 20% QoQ rise in contract sales for 2Q24, maintaining a MoM growth for two consecutive months. China Merchants Shekou (001979 CH) recorded a 51% QoQ increase in contract sales for 2Q24, also with two consecutive months of MoM growth. By contract sales volume, Poly Developments, China Overseas Land, Vanke, China Merchants Shekou, and China Resources Land (1109 HK) rank as the five largest real estate developers.

Poly Developments reported that following the Central Committee Political Bureau meeting in 2024, and the announcement of the "517 New Policy" by PBOC, various ministries and local governments have introduced supportive measures for the real estate sector, resulting in increased market activity. The company's nationwide projects averaged ~50,000 in client visits weekly in May and Jun, marking a 32% MoM increase from Apr and returning to the elevated visitation levels observed in Mar and Apr 2023. As the nation's largest developer, this rebound in foot traffic could signal an early revival in buying interest.

Despite their QoQ sales growth in 2Q24, performance in 1H24 was subdued due to a weak 1Q24. During 1H24, YoY contract sales value for Poly Development, China Overseas Land, Vanke, and China Merchants Shekou fell by 27%, 18%, 38%, and 39%, respectively.

Performance risks have surfaced. The downturn in the real estate market from 2022 to 2023 is reflected in the financial results of real estate developers for 1H24. Poly Developments forecasts that its net profit for 1H24 will decrease by ~39% to RMB 7.5bn. This represents an improvement from a 1Q24 net profit of RMB 2.2bn (down 18% YoY) to a 2Q24 net profit of RMB 5.3bn (down 44% YoY). The company attributes this decline in profit to a slight increase in revenue of 1.64% compared to the same period last year, while the gross margin suffered due to market downturns and pricing pressures. This trend reflects the adverse effects that real estate companies' promotional pricing is having on their financial performance.Vanke forecasts a net loss of RMB 7-9bn for 1H24, indicating its net loss increased from RMB 360mn in 1Q24 to RMB 6.6-8.6bn in 2Q24. Gemdale Corporation (600383 CH) anticipates a net loss of RMB 3.0-3.6bn for 1H24, suggesting its net loss rose from RMB 0.27bn in 1Q24 to RMB 2.7-3.3bn in 2Q24.

From the end of Mar until Jul 11, the stock performance of the top five real estate companies has varied significantly, reflecting different market preferences. Poly Developments, China Merchants Shekou, and Vanke A shares have respectively declined by ~1.5%, ~2.5%, and

~20%. During the same period, China Overseas Land and China Resources Land have seen increases of ~12% and ~6%, respectively, while Vanke H shares have fallen by ~4%.

Exhibit 7: Poly Developments contract sales amount (RMB mn)

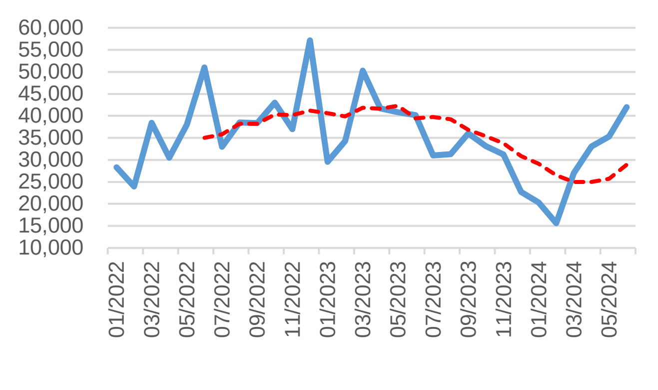
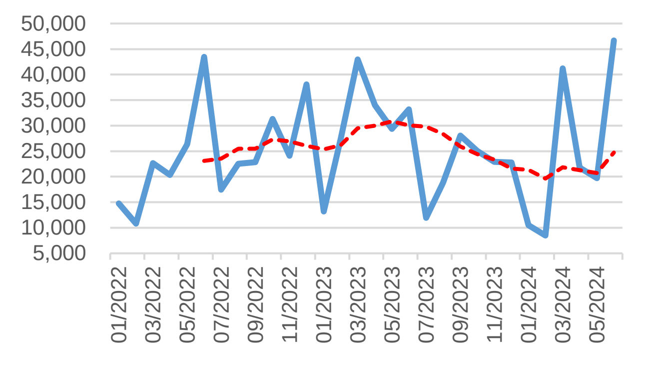


Exhibit 8: China Overseas Land contract sales amount (RMB mn)



Source(s):Poly Developments, COLI, ABCI Securities

Data as of 6/2024；Red dashed line ： 6-mth avg

Exhibit 9: Vanke contract sales amount (RMB mn)

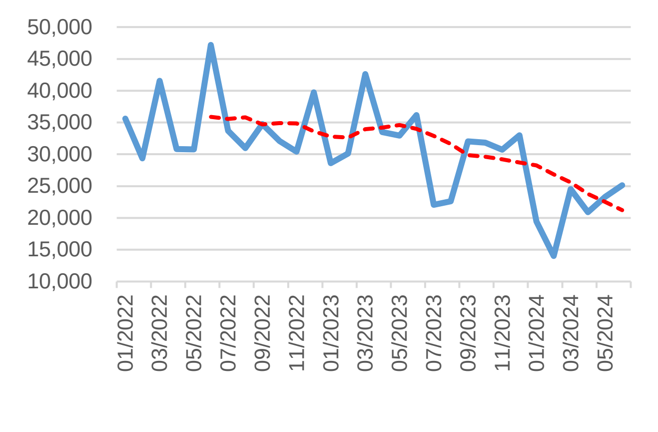
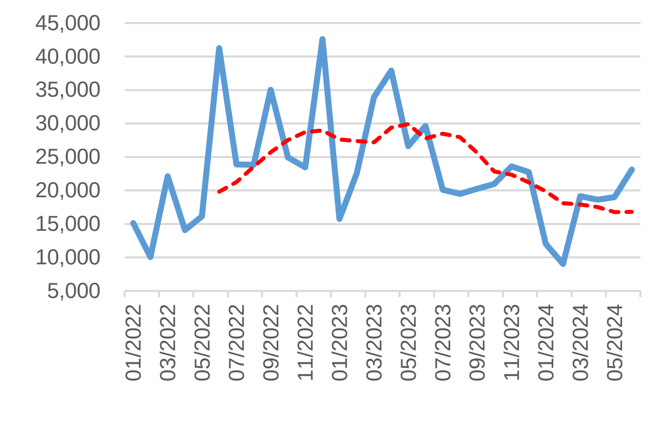


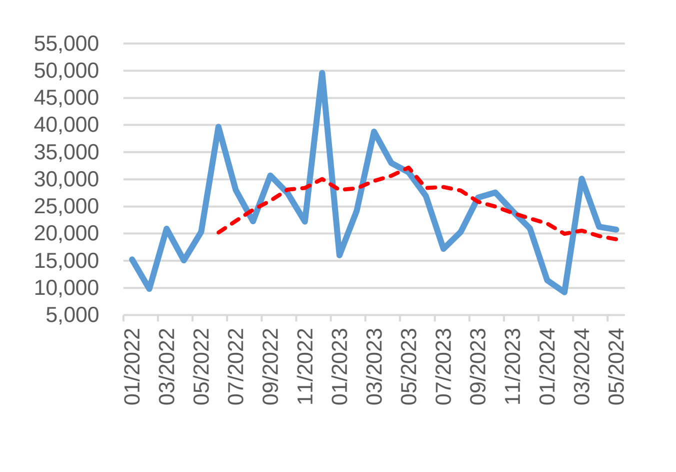
Exhibit 10 China Merchants Shekou contract sales amount（RMB mn）



Source(s): Vanke, China Merchants Shekou, ABCI Securities

Data as of 6/2024； Red dashed line：6-mth avg

Exhibit 11: China Resources Land contract sales amount（RMB mn）



Red dashed line：6-mth avg; Data as of 5/2024
Source(s): CR Land, ABCI Securities

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Disclosures of Interests
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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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