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ABC INTERNATIONAL
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Hong Kong Stock Market Weekly Review

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4/10/2024

- **How Will Hong Kong Stocks Be Valued at If a Bull Market Emerges?**
- **Understanding the Competitiveness of Tech Companies from the Perspective of Product Cost-Effectiveness**
- **Geopolitical Tensions in the Middle East Escalate, Causing International Oil Prices to Soar**

How Will Hong Kong Stocks Be Valued at If a Bull Market Emerges?

This week, the transaction amount in the Hong Kong stock market has significantly increased, with the current HSI ~30% above its 250-day moving average. Typically, when the index surpasses the 250-day average, the market interprets this as the start of a bull market. Investors, therefore, need to evaluate both risks and returns when making their investment decisions. One pertinent question for investors is about the potential magnitude of returns if a bull market is indeed forthcoming.

When most market commentators are predicting the onset of a bull market, it's essential to understand what truly defines a bull market. There are diverse views on this. We believe that a bull market is characterized by a rising stock market and by the market achieving valuations that exceed the historical average. If the market's valuation is below the historical average, then the upward trend might be just a recovery from a low point, not a genuine bull market.

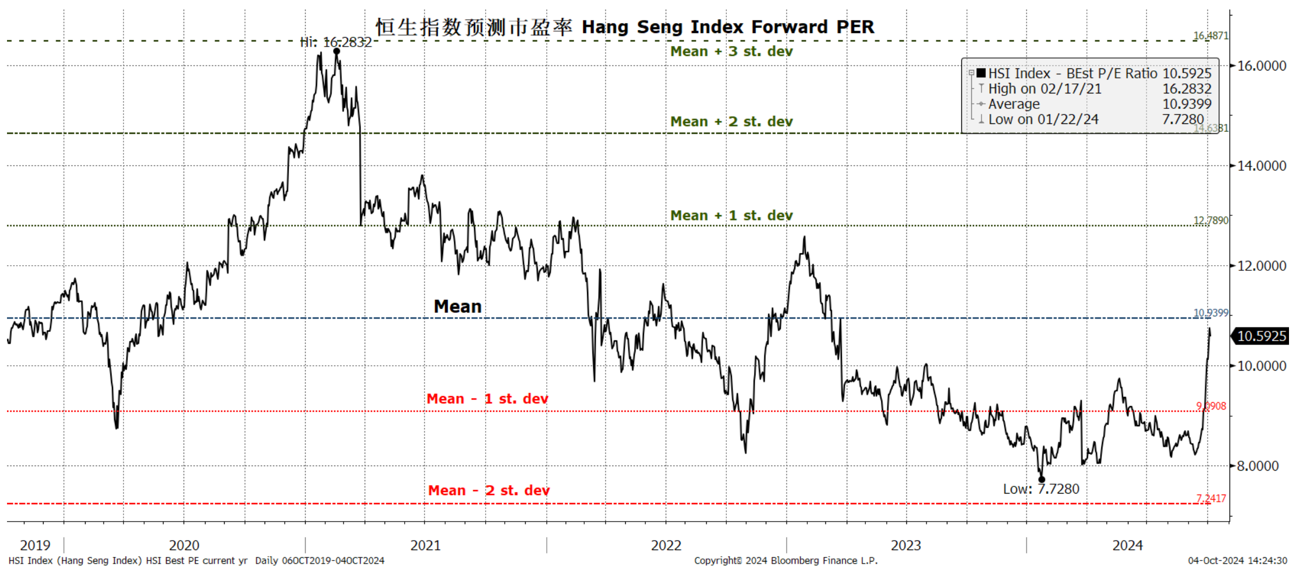
The valuation characteristics of the last bull market in 2021 provide a good reference. Based on 2021 earnings forecasts, the P/E ratio for the HSI ranges from 11.9 to 16.3 times, averaging 13.3 times (for ease of discussion, readers might consider a range of ~12 to 16 times, with an average of ~13 times). In the past five years, the HSI's forecasted P/E ratio has varied from 7.7 to 16.3 times, with an average of 10.9 times (for ease of discussion, readers might consider a range of ~8 to 16 times, with an average of ~11 times).

Currently, based on the 2024 earnings forecast, HSI's P/E ratio is 10.6 times, which remains below the five-year historical average. Positively, the current valuation is still attractive relative to the historical average, which likely explains the significant investor interest in major Hong Kong stocks this week. From a bleaker perspective, the valuation is still under the historical average, and the recent stock market rise is merely a rebound from a low, not a genuine bull market.

Should a genuine bull market emerge in Hong Kong stocks, what levels could the HSI achieve? Based on the current earnings forecast for 2024, if the HSI's P/E ratio reaches about 13 times, the index would approximate 27,400 points. If it replicates the peak P/E ratio of 2021, with the HSI's valuation rising to about 16 times based on the 2024 earnings forecast, the index could climb to 33,700 points. On Feb 18 2021, the HSI reached its highest point at 31,183.36, a 48% increase from its 2020 lowest point. At that time, the market had not anticipated that the HSI could surge from the Mar 2020 low of 21,139.26 to the high of 31,183.36 in Feb 2021 within just 12 months. The question remains whether history might repeat itself. However, this reference data can assist readers in evaluating potential risks and returns when planning their investment strategies.

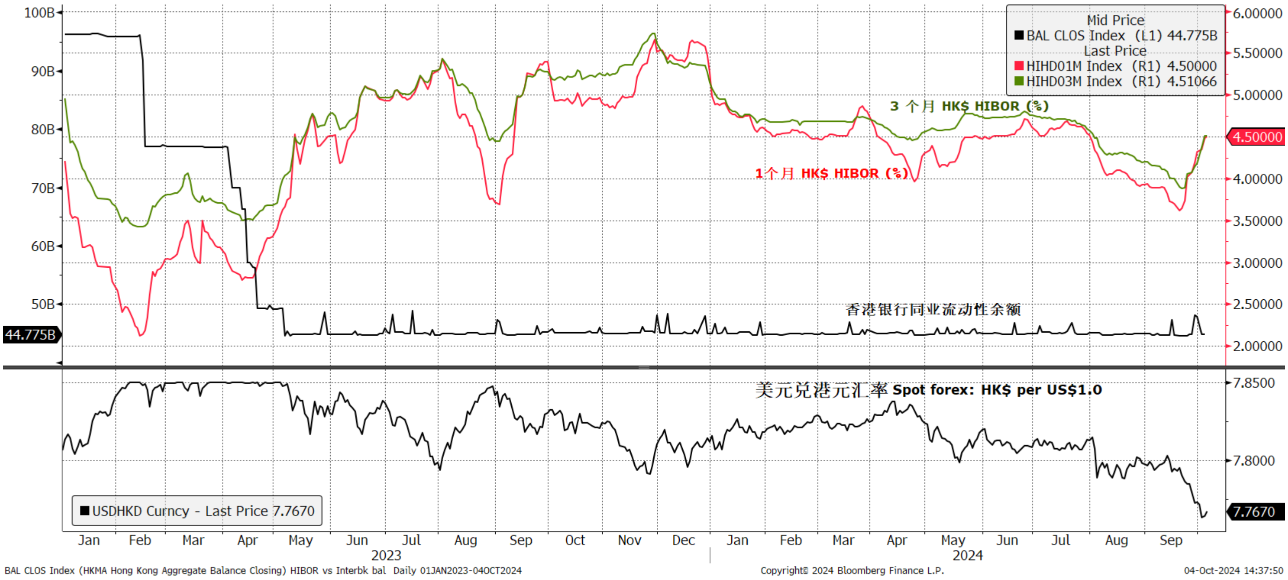
Therefore, we will be observing the following points in the coming weeks. First, we will see if the HSI will rise and surpass the 23,000 point mark, which corresponds to ~11 times the P/E ratio, or the historical average price-to-earnings ratio. Secondly, we will determine if optimistic expectations about the economy will become the dominant factor in investors' decisions, rather than decisions being driven by historical economic data. This is particularly relevant as, in mid-Oct, China will release a series of historical economic data for Sep or 3Q24. Given the latest monetary policies aimed at supporting the economy and the capital markets, our economists predict that China's GDP growth rate will rebound from 4.7% in 3Q24 to 5.3% in 4Q24. We anticipate that the historical data will indicate that the economy was weak in 3Q24 but expect a more optimistic outlook for 4Q24. Thirdly, we will monitor the trend of liquidity inflows in the stock market. Stock prices, like other asset prices, are driven by supply and demand dynamics. Continuous liquidity inflows are crucial for the stock market's rise. The USD to HKD exchange rate provides a good dynamic parameter to gauge these liquidity inflows. When a substantial amount of liquidity continues to flow into Hong Kong, resulting in strong demand for the HKD, the HKD exchange rate will remain robust.

Exhibit 1: Fluctuation range of HSI P/E Ratio over the past 5 years



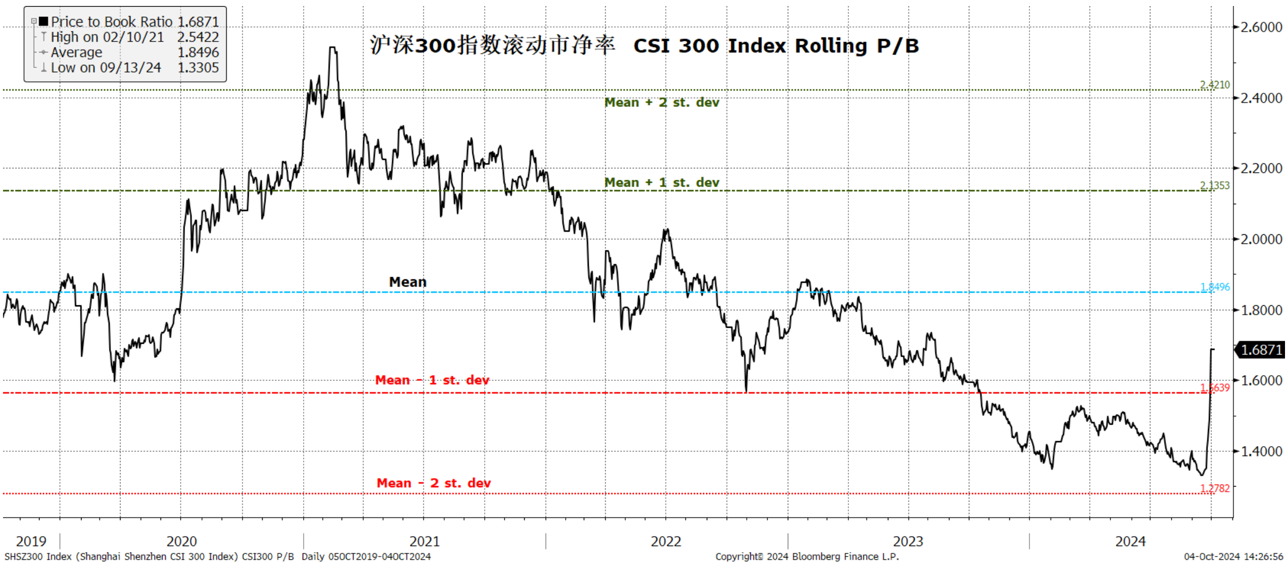
Note: Data as of 3/10/2024，HSI: 22113.51
Source(s)： Bloomberg, ABCI Securities

Exhibit 2: (Top) Recent boom in investment market leads to a sharp increase in capital demand in Hong Kong, driving up interbank market rates
(Below) While hot money flows into Hong Kong, boosting the demand for HKD and elevating the exchange rate



Note: Data as of 3/10/2024，HSI: 22113.51
Source(s)：Bloomberg, ABCI Securities

Exhibit 3: CSI 300 Index rolling P/B ratio over the past 5 years: A-share market rallies before end-Sep holiday, hinting at optimistic post-holiday trading and boosting investment sentiment in Hong Kong stocks
P/B ratio over the past five years is ~1.85 times, currently around 1.69 times. During the 2021 bull market, the average rolling P/B ratio was about 2.25 times, peaking at 2.54 times



Note: Data as of 30/9/2024，CSI 300 Index: 4017.85
Source(s): Bloomberg, ABCI Securities

2. Understanding the Competitiveness of Tech Companies from the Perspective of Product Cost-Effectiveness

High-growth or emerging industries such as AI, LiDAR, NEVs, biopharmaceuticals, wind power equipment, and solar power equipment have recently experienced a common trend: intense price competition. Market observations consistently reveal price wars. Indeed, competition extends beyond mere pricing—it's about the cost-effectiveness of products. Price wars typically arise when products with lower cost-effectiveness need further price reductions to bolster their value proposition, especially when new, more cost-effective products enter the market, compelling less competitive products to drop prices or exit the market altogether.

In the US, several prominent lidar companies face financial difficulties or are nearing bankruptcy. Some were global market leaders in past years. Their current predicament is largely due to their products' diminishing cost-effectiveness over recent years and the introduction of more competitively priced products by Chinese lidar firms.

Although new products may appear more expensive, their higher cost-effectiveness potentially offers better value. From a cost-effectiveness standpoint, these new offerings might effectively be cheaper. This trend is particularly evident in the equipment sector, such as AI chips. Consider Nvidia (NVDA US), which is acknowledged globally as a leader in the AI chip market. While readers might not be familiar with chip technology, they likely understand the significance of AI chips. Indeed, assessing a company's prospects from the perspective of its products' cost-effectiveness provides deeper insights than merely considering their technical specifications.

Currently, Nvidia's top-selling AI products are the A100 and H100 chips, with the upcoming Blackwell product soon to be released. The H100 chip is more advanced than the A100, costing ~1.8 times as much. The Blackwell chip surpasses the H100 in advancement, priced at about 1.4 times that of the H100 and roughly 2.5 times that of the A100. Despite the A100's lower price in absolute terms, it is not necessarily the most competitive option.

In terms of cost-effectiveness, the Blackwell chip ranks highest, while the A100 is the least competitive. For instance, a complex task that 10,000 Blackwell chips could complete would require about 1.3 million A100 chips or 100,000 H100 chips. From a buyer's perspective, the overall cost savings achieved by using Blackwell chips, compared to the total costs of using A100 or H100 chips, are significant. This represents a major competitive advantage in terms of the cost-effectiveness of the Blackwell product.

Furthermore, AI chips consume considerable electricity during operations, making energy efficiency a crucial factor in their cost-effectiveness. For the same complex task, the total energy consumption of Blackwell chips is only about 10% of that required by the A100 chips or ~ 20% of that needed for the H100 chip.

The said example illustrates that while we may not fully grasp all the details of AI technology, from a business perspective, the crucial aspect is not just the technology itself but rather the gap in cost-effectiveness between new products and existing ones on the market. When Nvidia faces new products from competitors that approach the capabilities of its A100 or H100 chips, it introduces products that offer a significantly better cost-effectiveness ratio.

This article does not intend to promote Nvidia stock. Rather, we are highlighting the importance of cost-effectiveness when evaluating a tech company. As technology advances rapidly, it becomes challenging to assess the merits of new technologies or products accurately without specific knowledge of the domain. However, by focusing on the cost-effectiveness of products from tech companies and their competitors, readers might find a simpler and more comprehensible way to assess the competitiveness of these companies.

3. Geopolitical Tensions in the Middle East Escalate, Causing International Oil Prices to Soar

Since the end of Sep, there has been a significant increase in international crude oil prices. Active US crude oil futures rose from US$ 68.17 per barrel at the end of Sep to US$ 73.67 per barrel on Oct 4, an increase of ~8%. European Brent crude futures increased from US$71.70 per barrel to US$77.95 per barrel over the same period, marking a rise of ~9%. There are multiple factors behind the early Oct surge in oil prices.

On the supply side, escalating tensions between Israel and Iran have raised market fears that further conflicts could tighten oil supplies. This could potentially reduce or interrupt Iran's oil output and negatively impact the broader Middle East oil supply. For US and European oil producers, reducing Middle Eastern oil supply could be beneficial as it might allow them to increase their market share and sell oil at higher prices. Although OPEC announced plans to increase production post-Sep, these plans could be undermined if the Israeli-Iranian conflict disrupts Middle Eastern oil exports.

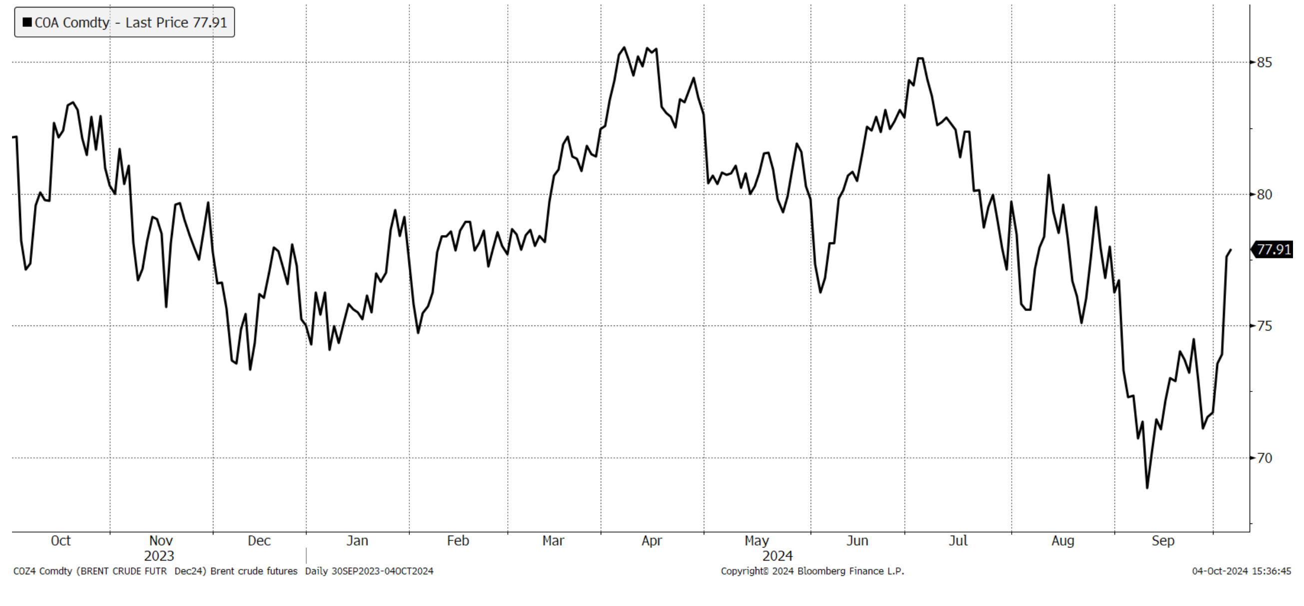
On the demand side, China's announcement of monetary policy measures to support its economy in late Sep positively impacted commodity markets. This led to expectations that a rebound in China's economy would drive global demand for energy and other commodities.

The Shanghai crude oil futures market will reopen on Oct 8 after the National Day holiday. It is expected that the domestic crude oil futures market will rise following the trend in international oil prices. This week, the stock prices of CNOOC (883 HK), PetroChina (857 HK), and Sinopec (386 HK) on the Hong Kong Stock Exchange increased by ~12%, 4%, and 6%, respectively. The market's response also highlights investors' differing preferences for China's three major energy stocks following the significant rebound in crude oil prices at the start of Oct.

Exhibit 4: US WTI Active Crude Oil Futures Prices (US$/barrel)

Source(s): Bloomberg , ABCI Securities

Exhibit 5: European Brent Crude Oil Futures Prices (US$/barrel)



Source(s): Bloomberg , 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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