



Strategy
PBoC Cut Rates & RRR

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Strategy Update

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Buy H-shares to position for macro improvement ahead

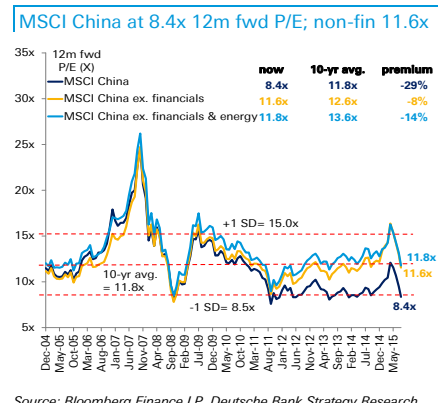
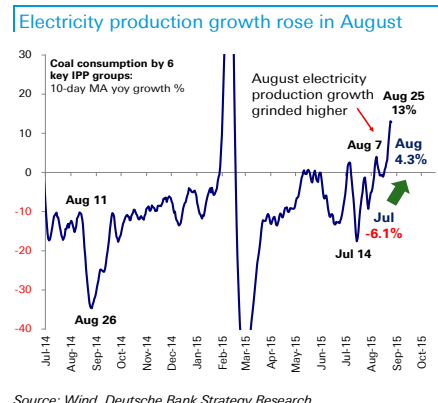
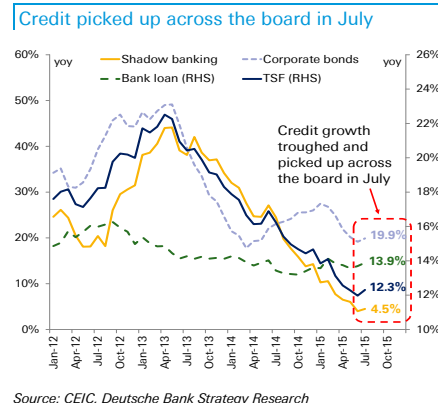
PBoC cut interest rates and RRR, reaffirming that policy priority is growth
The PBoC today announced a 25bps cut in benchmark interest rates and 50bps cut in RRR. The central bank also removed the cap on long-term (above 1-year) deposit rates to further liberalize domestic interest rates and cut RRR by 300bps for financial leasing and auto finance companies. This move is largely in-line with our expectations and **reaffirmed that the leadership's policy priority is growth support.** Looking ahead, **our chief China economist forecasts one RRR cut in each of the coming quarters in 2015 and 2016,** together with intensifying fiscal stimulus; we look for macro improvement ahead and higher-than-consensus GDP growth of 7.2% in 4Q15 (Figure 1).

Market dipped and appeared oversold amid jittery sentiment
H-shares dropped below the earlier index bottom on 8 July and reached a two-year low. Currently, the **MSCI China index trades at 8.4x 12-month forward P/E, at a 28% discount to the 10-year average** (Figure 3). The non-financial MSCI China is now at 11.8x; if we exclude the 26x valued Tencent, non-financials would be at only 10.4x. Based on current index levels, **the implied H-share equity risk premium stands at an elevated 8.3%** vs. a 10-year average of 5.4% (Figure 4), suggesting that investors may have priced in some pretty bad scenarios; in other words, **for market valuations to slide further, the actual situation would need to be a lot worse than investors thought.**

Apart from low valuations and low investor expectations, **H-shares also look oversold technically speaking,** with the 14-day RSI of the HSCEI falling to 16 (Figure 5), implying that selling pressure may have been exhausted in the near term. In addition, based on empirical observations since the Global Financial Crisis (Figure 6), **current valuations of 8.4x may provide visible valuation support** to the MSCI China index. We note that today is the second day with **more than Rmb8bn net inflows (> 60% of daily quota) to buy A-shares via the northbound Shanghai-HK Stock Connect** (Figure 2).

We continue to see macro improvement ahead based on leading indicators
Looking ahead, **we continue to expect fundamental improvement in China in 2H15** based on the top-down signals we identified in a recent note, **Top-down signals suggest macro improvement ahead: Buy H-shares: 1) accelerating fiscal expenditures** could boost infrastructure FAI (Figure 7); **2) recovering property sales** may increase new starts and property investment (Figure 8); and **3) an across-the-board credit growth pickup** in July (Figure 9) points to rising industrial activity ahead (Figure 10). We also notice **some positive bottom-up micro indicators, including 1) escalating electricity production growth** so far in August at 4.3%, vs. -6.1% in July (Figure 11), implying improving industrial production; and **2) stabilizing materials prices,** including cement, steel and coal (Figure 12). We will closely watch the official August PMI due by 1 September and **detailed August macro data release due by 12 September** to verify our positive expectations.

Staying positive in 2H15; we expect HSCEI to reach 13,000 by end-2015
We maintain our positive H-share outlook in 2H15. In order to adjust for heightened market volatility and recent RMB movement, **we slightly lower our end-2015 index targets to 78 for MSCI China and 13,000 for HSCEI.** We



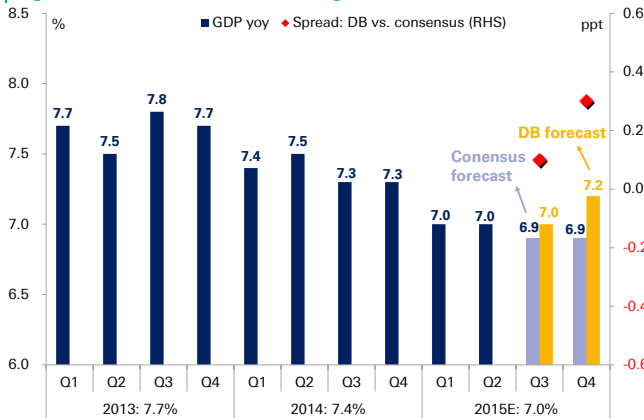
continue to **recommend property (COLI), infrastructure (CRCC), cement (BBMG), insurance (Ping An) and TMT (BIDU)**. See Figure 13 for our sector preferences and Figure 14 for our top-10 picks in China.

For investors looking to gain from a near-term technical bounce, **we highlight two stock screens:**

- **Oversold H-shares** that **1)** were mostly shorted in the past month; **2)** have a 14-day RSI < 30; and **3)** trade at a 12-month forward P/E in the lower part of the past five-year range. We notice some **Buy-rated quality names** showing up in the screen, including Anhui Conch (914 HK), Hengan (1044 HK), CITIC Securities (6030 HK), Brilliance China (1114 HK) and Mengniu Dairy (2319 HK).
- **H-shares that have a business model leveraged to the capital market**, including insurance, brokers and asset managers (Figure 16).

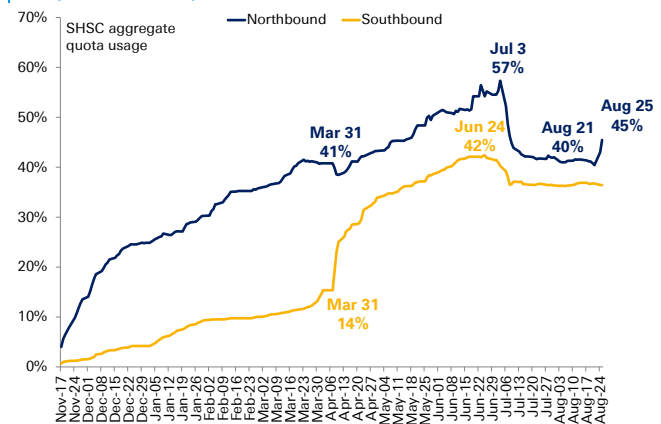


Figure 1: We look for macro improvement ahead and higher-than-consensus GDP growth in 2H15



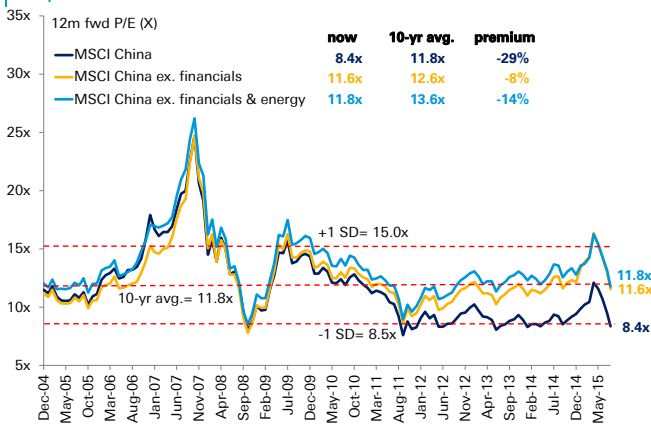
Source: Bloomberg Finance LP, Deutsche Bank Strategy Research

Figure 2: SHSC northbound saw Rmb8bn net inflows in the past two days



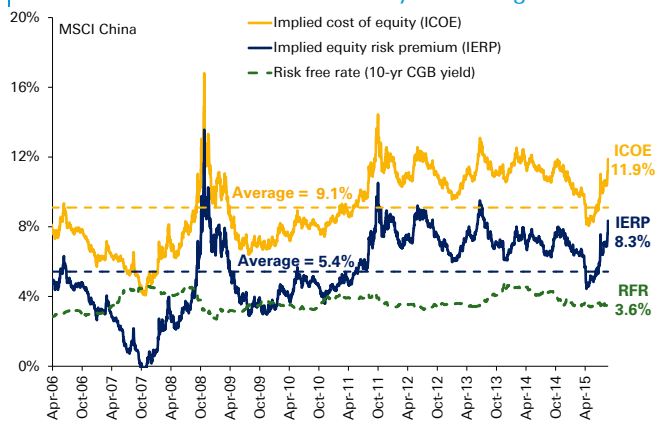
Source: Bloomberg Finance LP, Deutsche Bank Strategy Research

Figure 3: MSCI China now trades at 8.4x 12m forward P/E, non-financials at 11.6x



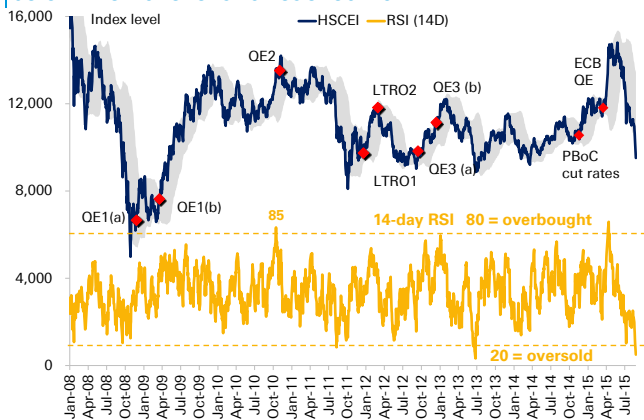
Source: Bloomberg Finance LP, MSCI, Deutsche Bank Strategy Research

Figure 4: Implied H-share equity risk premium (IERP) stands at an elevated 8.3% vs. 10-year average of 5.4%



Source: Bloomberg Finance LP, MSCI, Deutsche Bank Strategy Research

Figure 5: HSCIE looks oversold as its 14-day RSI plunged below the 20 level and reached 16



Source: Bloomberg Finance LP, Deutsche Bank Strategy Research

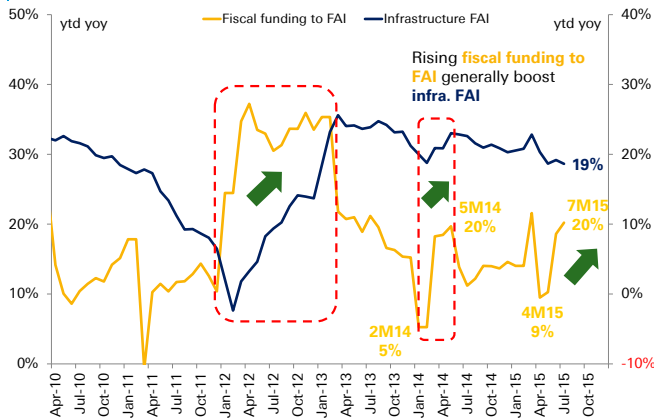
Figure 6: Empirical observations suggest current 8.4x 12m forward P/E may provide visible support



Source: Bloomberg Finance LP, MSCI, Deutsche Bank Strategy Research

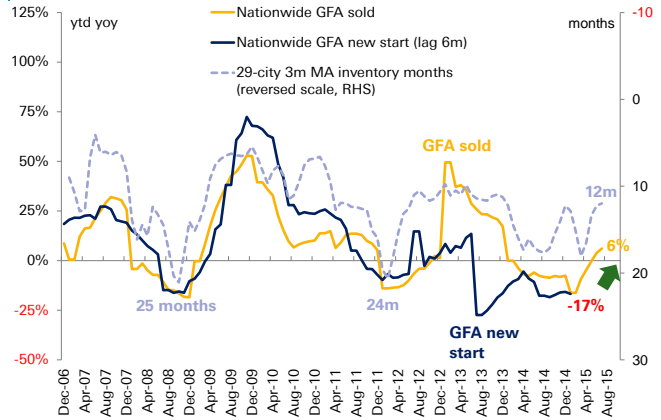


Figure 7: Accelerating fiscal expenditures in the past two months could boost infrastructure FAI



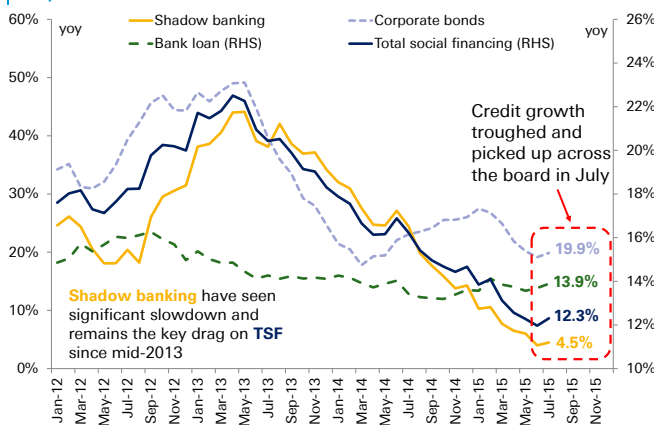
Source: CEIC, Deutsche Bank Strategy Research

Figure 8: Recovering property sales may increase new starts and property investment



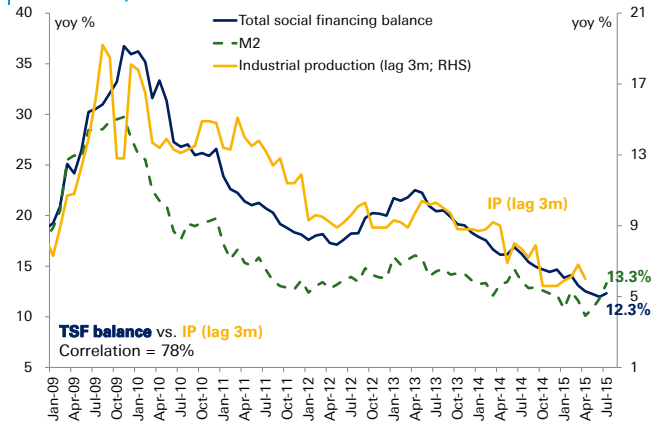
Source: CEIC, SouFun, Deutsche Bank Strategy Research

Figure 9: Credit growth picked up across the board in July



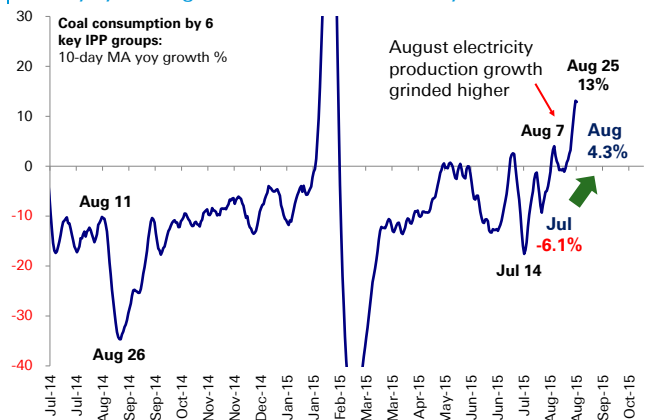
Source: CEIC, Deutsche Bank Strategy Research

Figure 10: Credit expansion generally leads to rising industrial production after three months



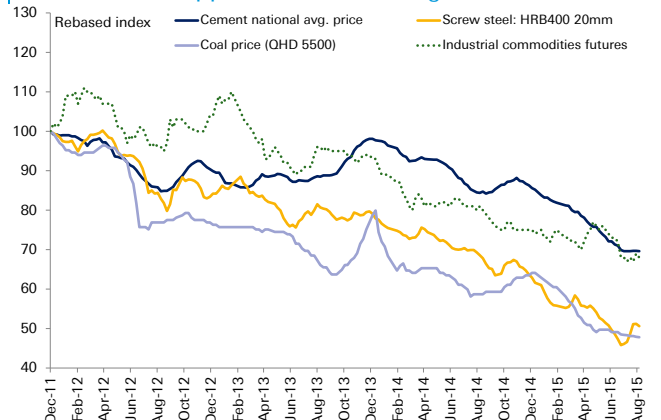
Source: Bloomberg Finance LP, Deutsche Bank Strategy Research

Figure 11: Coal consumed for electricity production grew 4.3% yoy in August MTD vs. -6% in July



Source: Wind, Deutsche Bank Strategy Research

Figure 12: Onshore materials prices, including cement, steel and coal, appear to be stabilizing



Source: Wind, Deutsche Bank Strategy Research
Note: Industrial commodities comprise active futures of domestic aluminum, copper, coke, polyethylene, lead, screw steel, rubber, PTA, PVC and Zinc



Figure 13: We suggest overweight financials, info tech, industrials and utilities, while underweight telecom and energy; we are market-weight on banks, consumer, healthcare and materials

MSCI China GICS Sector		Index weight	Advised weight	Diff.	12m fwd P/E (X)	12m trl P/B (X)	5-yr val. z-score	Overweight	Market-weight	Underweight
Over-weight (OW)	Financials	42%	45%	3%	5.7	1.0	-1.2	Insurance Diversified Financials Real Estate	Banks	
	Info. Tech.	15%	18%	3%	22.3	7.2	0.2	Internet & Software	Hardware & Semicon	
	Industrials	8%	10%	2%	9.7	1.1	-0.6	Capital Goods	Transportation	
	Utilities	4%	6%	2%	10.1	1.8	-1.3	IPPs Water/Gas/Renew.		
Market-weight (MW)	Cons. Disc.	4%	4%	0%	7.6	1.7	-2.6		Automobiles Retailing & Others	
	Cons. Stap.	4%	4%	0%	20.8	1.3	-0.8		Food & Beverage Household Products	
	Health Care	2%	2%	0%	15.6	2.7	-1.2		Health Care	
	Materials	2%	2%	0%	9.5	0.9	-0.1	Construction Materials		Other Basic Materials
Under-weight (UW)	Telecom	12%	7%	-5%	13.4	1.6	1.3			Telecom
	Energy	8%	3%	-5%	10.7	0.8	0.8			Oil, Gas & Services Coal

Source: Bloomberg Finance LP, MSCI, Deutsche Bank Strategy Research

Note: 5-year valuation z-score refers to the standard deviation from past 5-year historical average in terms 12-month forward P/E, except for financials, which are based on 12-month trailing P/B

Figure 14: Deutsche Bank 2015 China top-10 picks

DB 2015 China Top-10 Picks								Themes			Consensus Estimates (calendarized)						DB Rating		
Ticker	Company Name	GICS Sector	Price		Shr-class		5-yr Beta	C	T	R	M	15E P/E	15E P/B	15E ROAE	15E Div. Yield	15E EPS Gwth	16E EPS Gwth	DB Rating	Target Price
			Aug 25 (LOC)	Return YTD	Mkt Cap (USDm)	3M ADT (USDm)													
939 HK	CCB	Financials	5.46	-14%	169,339	324	1.0					4.8	0.8	18%	6.8%	3%	5%	Buy	8.5
2318 HK	Ping An	Financials	36.50	-8%	35,068	354	1.2	√	√			9.9	1.5	16%	1.7%	24%	6%	Buy	60.0
688 HK	COLI	Financials	21.50	-7%	27,349	79	1.2	√				6.8	1.1	17%	2.9%	8%	13%	Buy	30.3
6030 HK	Citic Securities	Financials	16.58	-43%	4,873	102	1.4	√	√			9.1	1.3	14%	2.9%	47%	11%	Buy	26.7
1186 HK	CRCC	Industrials	9.48	-4%	2,539	30	1.2	√	√			7.9	0.9	13%	2.0%	8%	9%	Buy	15.4
2009 HK	BBMG	Materials	4.85	-25%	732	10	1.4	√	√	√		9.9	0.6	8%	1.2%	-22%	47%	Hold	7.3
BIDU US	Baidu	Info. Tech.	141.08	-38%	39,019	751	0.7	√	√	√		24.9	4.9	21%	0.0%	-9%	30%	Hold	206.0
2380 HK	China Power Int'l	Utilities	4.52	15%	4,263	22	0.8	√	√			8.1	1.1	15%	5.7%	10%	1%	Buy	7.6
371 HK	BEWG	Utilities	5.10	-4%	5,735	14	0.9	√				19.9	2.5	14%	1.8%	23%	28%	Buy	7.2
958 HK	Huaneng Renewables	Utilities	2.46	0%	1,331	13	0.8	√	√			11.1	1.1	10%	1.7%	48%	26%	Buy	3.7
			Equal weight	-13%	29,025	170	1.1					11.2	1.6	14%	2.7%	14%	17%		

Source: Bloomberg Finance LP, Deutsche Bank Strategy Research

Note: On themes, C refers to cost savers, T refers to top-line growers, R refers to reform beneficiaries, and M refers to MSCI inclusion



Figure 15: Oversold stock screen: 1) mostly shorted in August; 2) technically oversold as 14-day RSI < 30; and 3) 12-month forward P/E in the lower part of the past five-year range (12m fwd P/E z-score<0)

Trading prices											DB Research					
Ticker	Company Name	GICS Sector	Price as of Aug 25	Return YTD	Shr-class cap 3m ADT (USDm)	RSI 14D	Avg. short sell as % of total vol. since Aug	12M FWD P/E 15E	5-yr Z-score	P/B 15E	ROE 15E	Div. yld 15E	EPS CAGR 14-16E	Rating	Target price	
Technically oversold H-shares that have been heavily shorted																
168 HK	Tsingtao Brew-H	Cons. Stap.	38.00	-28%	3,212	12.7	26	43%	20.1	-2.2	2.7	13%	2%	8%	Hold	55.00
2238 HK	Guangzhou Auto-H	Cons. Disc.	5.29	-25%	1,511	11.1	28	36%	7.8	-1.1	0.8	10%	4%	19%	Hold	7.40
914 HK	Anhui Conch-H	Materials	21.35	-27%	3,580	43.8	29	36%	10.1	-0.6	1.4	14%	3%	-3%	Buy	31.64
175 HK	Geely Automobile	Cons. Disc.	2.63	6%	2,987	20.2	22	32%	7.6	-1.3	1.1	13%	2%	47%	Buy	4.00
1044 HK	Hengan Intl	Cons. Stap.	75.75	-7%	11,967	25.7	27	31%	20.4	-2.3	5.2	25%	3%	16%	Buy	95.10
2007 HK	Country Garden	Financials	2.62	-15%	7,635	12.4	20	31%	4.7	-1.0	0.8	16%	7%	-2%	Sell	2.60
2883 HK	China Oilfield-H	Energy	7.76	-42%	1,813	19.9	22	29%	10.5	-0.4	0.7	6%	3%	-29%	Hold	11.86
3360 HK	Far East Horizon	Financials	6.10	-20%	3,109	7.8	23	29%	6.3	-0.8	1.0	15%	4%	17%	N/A	N/A
6030 HK	Citic Sec-H	Financials	16.58	-43%	4,874	101.8	25	29%	9.1	-3.2	1.6	14%	3%	27%	Buy	26.70
1114 HK	Brilliance China	Cons. Disc.	8.60	-31%	5,576	28.8	25	26%	8.2	-1.6	2.1	22%	1%	0%	Buy	11.40
699 HK	Car Inc	Industrials	12.78	23%	3,910	25.2	29	26%	22.9	-2.8	5.2	16%	N/A	91%	N/A	N/A
135 HK	Kunlun Energy	Energy	4.89	-33%	5,093	14.8	12	25%	9.1	-2.8	0.7	8%	3%	-2%	Hold	7.10
2689 HK	Nine Dragons Pap	Materials	4.42	-35%	2,661	10.9	26	25%	9.1	-0.9	0.7	6%	3%	9%	Buy	7.64
257 HK	China Everbr Int	Industrials	9.38	-19%	5,426	15.4	24	25%	18.5	-0.5	2.8	13%	1%	33%	Hold	14.00
3323 HK	China Natl Bdg-H	Materials	4.59	-39%	1,705	27.0	28	24%	4.8	-0.8	0.5	9%	3%	-10%	Sell	3.30
2319 HK	Mengniu Dairy	Cons. Stap.	30.15	-6%	7,629	28.1	24	21%	17.8	-1.3	2.3	12%	1%	17%	Buy	41.30
493 HK	Gome Electrical	Cons. Disc.	1.13	-1%	2,473	46.2	28	21%	11.4	-0.7	1.0	8%	3%	10%	Buy	1.82
3383 HK	Agile Property	Financials	3.70	-16%	1,870	6.9	18	20%	3.2	-1.0	0.3	10%	9%	-9%	Sell	3.55
3900 HK	Greentown China	Financials	5.75	-25%	1,604	6.4	20	19%	3.3	-0.3	0.4	12%	6%	27%	Buy	15.25
1988 HK	Minsheng Bank-H	Financials	7.45	-27%	6,665	48.0	19	19%	4.6	-0.5	0.9	18%	4%	4%	Buy	12.62

Source: Bloomberg Finance LP, Deutsche Bank Strategy Research
Note: 12M FWD P/E 5-yr Z-score=(current P/E - 5yr avg.)/(5yr standard deviation)

Figure 16: H-shares that have a business model leveraged to the capital market, including insurance, brokers and asset managers

Trading prices								Consensus valuation					DB Research	
Ticker	Company name	GICS Industry Group	Price as of Aug 25, 2015	Return YTD	Shr-class cap 3m ADT (USDm)	5-yr beta to MSCI China	P/E 15E	P/B 15E	ROE 15E	Div yld 15E	EPS CAGR 14-16E	Rating	Target price	
H-shares with leveraged business model to capital market														
2318 HK	Ping An-H	Insurance	36.50	-8%	35,067	350.2	1.3	9.9	1.5	16%	1.7%	14%	Buy	57.30
2628 HK	China Life-H	Insurance	24.95	-18%	23,950	192.7	1.3	13.0	1.8	14%	2.6%	26%	Buy	37.10
2601 HK	China Pacific-H	Insurance	26.20	-34%	9,380	61.3	1.4	12.6	1.4	12%	2.6%	25%	Buy	46.20
966 HK	China Taiping In	Insurance	18.56	-16%	8,605	33.4	1.6	10.8	1.1	11%	N/A	11%	Buy	33.90
6030 HK	Citic Sec-H	Div. Financials	16.58	-43%	4,873	101.8	1.8	9.1	1.3	14%	2.9%	27%	Buy	26.70
6837 HK	Haitong Securi-H	Div. Financials	10.76	-45%	4,733	137.2	1.6	6.8	1.0	16%	4.1%	29%	Buy	17.30
1359 HK	China Cinda-H	Div. Financials	2.98	-21%	4,482	47.5	1.1	5.8	0.9	15%	4.7%	24%	Buy	5.70
1339 HK	Picc Group-H	Insurance	3.49	-4%	3,929	36.8	1.3	7.9	1.1	14%	0.3%	11%	Hold	5.00
1336 HK	New China Life-H	Insurance	28.45	-27%	3,795	34.9	1.4	7.9	1.2	16%	1.3%	26%	Buy	55.70
165 HK	China Ever Ltd	Div. Financials	14.26	-23%	3,100	26.2	1.9	5.5	0.7	13%	6.1%	38%	N/A	N/A
6886 HK	Huatai Securit-H	Div. Financials	12.90	-48%	2,861	60.9	1.9	7.8	1.0	15%	3.8%	34%	Buy	20.70
1776 HK	Gf Securities-H	Div. Financials	11.54	-39%	2,533	34.4	1.9	6.0	1.0	20%	4.3%	31%	Buy	20.30
6881 HK	Cgs-H	Div. Financials	5.14	-47%	2,447	55.9	2.0	5.1	0.8	18%	5.8%	26%	Buy	8.30
806 HK	Value Partners	Div. Financials	6.61	1%	1,575	19.8	1.8	9.3	2.8	29%	4.2%	31%	N/A	N/A

Source: Bloomberg Finance LP, Deutsche Bank Strategy Research



Appendix 1

Important Disclosures

Additional information available upon request

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Buy: Based on a current 12-month view of total shareholder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield), we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total shareholder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Notes:

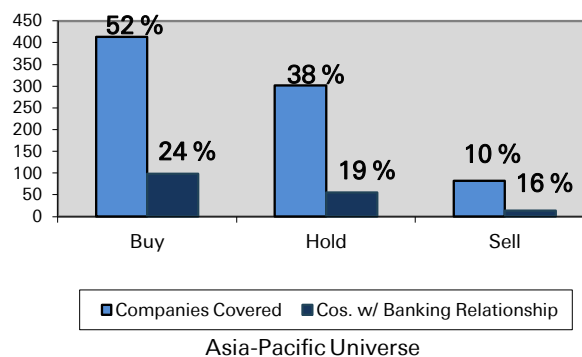
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Equity rating dispersion and banking relationships



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