Deutsche Bank
Markets Research

Asia
China

Strategy

Buy Chinese H-shares

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Strategy Update

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More upside amid stronger easing; UG property & banks, DG healthcare

Turning more positive on H-shares amid intensifying policy loosening

We have been positive on Chinese equities for 2015 but caution readers of a weak start to the year (see 2015 China Outlook). After H-shares' underperformance vs. DM, AsiaPac ex Japan and A-shares YTD, **we now see more upside risks than downside ones and turn more positive on the market,** in view of the following:

- **We expect Chinese policy-easing efforts to intensify in 2Q15** (see policy easing cycle may start soon), including monetary, fiscal and property relaxation, given the below-target 1Q15 growth and the "bottom-line"-focused reaction function reiterated by Premier Li during the NPC. We see lower market rates and resumed credit growth ahead, and our economist forecasts GDP to bottom in 1Q15 and edge up to 7.2% in 4Q15.
- **We believe the earnings cut cycle will come to an end by April,** as the disappointing FY14 results season wraps up and consensus estimates get closer to our top-down forecasts. For FY15, we look for more evidence of cost reduction among mid-stream sectors to reinforce our expectation of a margin-driven non-financial earnings recovery.
- **We see loosening global liquidity conditions and funds inflow as catalyzing catch-up with A-shares**, considering **1)** the Fed finally joined forces with other major central banks on the dovish side and suggested "lower for longer" rates over the coming quarters; **2)** still deeply discounted H-share valuations suggest light investor positions; and **3)** improving cyclical outlook and expediting reform in China.

Raising HSCEI target to 14,000; UG property & banks while DG healthcare

We raise our end-2015 index target for MSCI China to 80.3 based on 11x 12-month forward P/E and 5% earnings growth, implying 15% upside from here. Our end-2015 target for **HSCEI is revised up to 14,000**.

Sector-wise, we suggest **overweight financials (Ping An/CITICS/COLI/CCB), IT (BIDU), industrials (CRCC) and utilities (CPI/HD Fuxin)** and underweight telecom and energy. Compared to our previous recommendation, we **upgrade property to overweight** in anticipation of stronger policy support, **upgrade banks to market-weight** due to waning asset quality concerns, while we **downgrade healthcare to market-weight** given mounting pricing pressure.

Thematic-wise, we focus on **1) cost savers** (buy property, power and cement, sell energy and upstream metal mining), **2) top-line growers** (buy internet/ software and travel/leisure, sell retailing and food & beverage), **3) reform beneficiaries** (buy insurance, brokers and railway), **4) MSCI inclusion** (buy internet/software, sell financials, energy and telecom), and **5) resilient RMB** (buy outbound consumer services, sell exports & HK retail/landlords).

Risks

Key downside risks include muted policy reaction in China despite below-target growth, unexpected sizable credit events around LGFVs or highly leveraged developers, and tighter-than-expected Fed monetary stance.

Sector preference

Overweight	Financials Information Technology Industrials Utilities
Market-weight	Consumer Discretionary Consumer Staples Health Care Materials
Underweight	Telecom Energy

Source: Deutsche Bank Strategy Research

2015 China top-10 picks

Ticker	Company	Ticker	Company
2318 HK	Ping An	BIDU US	Baidu
688 HK	COLI	939 HK	CCB
6030 HK	Citic Securities	2380 HK	China Power Int'l
1186 HK	CRCC	371 HK	BEWG
2009 HK	BBMG	816 HK	Huadian Fuxin

Source: Deutsche Bank Strategy Research

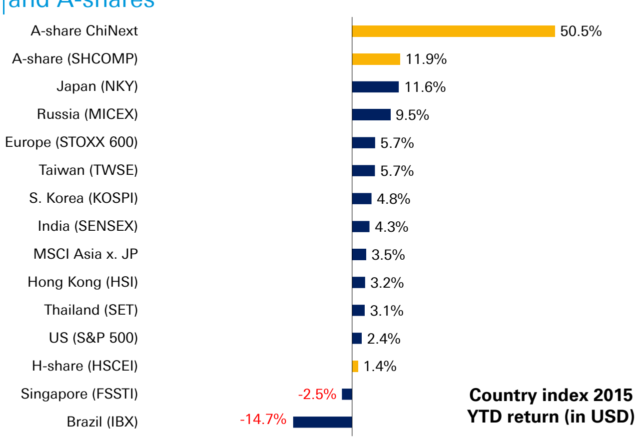
We turn more positive

The H-share market had a relatively weak return YTD, underperforming DMs, Asia ex. Japan and A-shares (Figure 1). Looking forward, **we are turning more positive on H-shares**, as we expect **1)** Chinese policy easing effort to intensify in 2Q15; **2)** earnings cut cycle should come to an end by April, **3)** global liquidity conditions to loosen and funds may flow in to spur catch-up with A-shares.

Chinese policy-easing effort to intensify in 2Q15

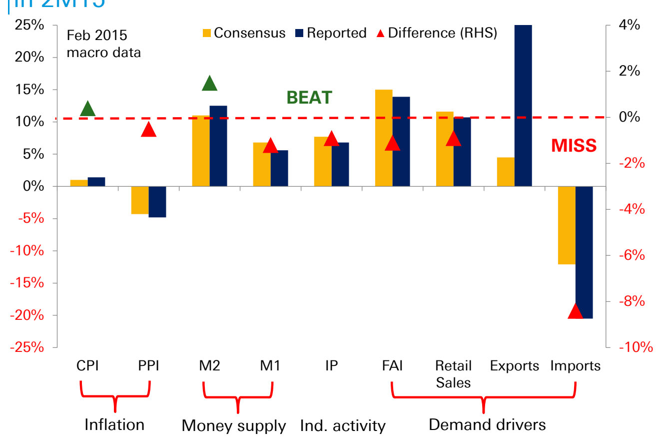
Major macro indicators including industrial production, FAI and retail sales **came in disappointingly in 2M15** (Figure 2); high-frequency micro indicators including the sluggish electricity production (proxied by coal consumption of major IPPs; Figure 3) and the softening domestic commodity prices (Figure 4) also suggest **extended weakness in March.** Our economist expects **1Q15 GDP growth (due by 15 April) to dip below the full-year target to 6.8%** due to the double whammy of fiscal revenue decline and a property market slowdown, and sees rising risks of a mini hard-landing (GDP < 6%) if policy response comes behind curve.

Figure 1: The H-share market had a relatively weak return YTD, underperforming major DMs, Asia ex. Japan and A-shares



Source: Bloomberg Finance LP, Deutsche Bank Strategy Research

Figure 2: Major macro indicators including industrial production, FAI and retail sales came in disappointingly in 2M15



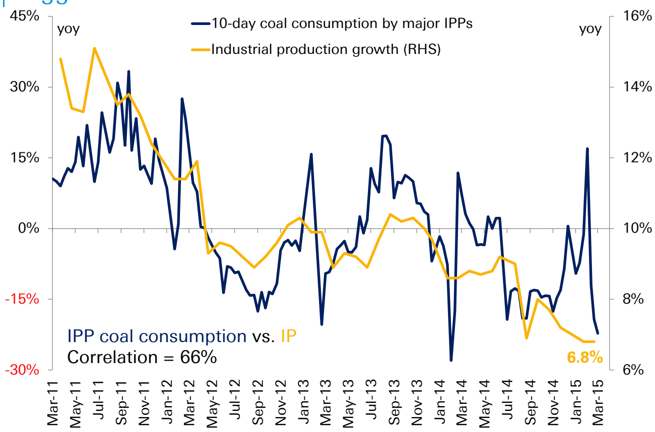
Source: Bloomberg Finance LP, Deutsche Bank Strategy Research

At the recent National People's Congress (NPC) meeting in early March, we noticed **Premier Li Keqiang mentioned in the 2015 Government Working Report**[1] that the no.1 task in 2015 is to "stabilize and improve macroeconomic policies [and] **make sure economic growth stays in the reasonable range**". We believe this is a **strengthened reiteration about the "bottom-line"-focused policy reaction function**, hinting that we will see stronger policy loosening when the economy grows below the level deemed desirable by the administration, which we think should be around the 2015 growth target of 7%.

[1] See http://www.gov.cn/guowuyuan/2015-03/16/content_2835101.htm

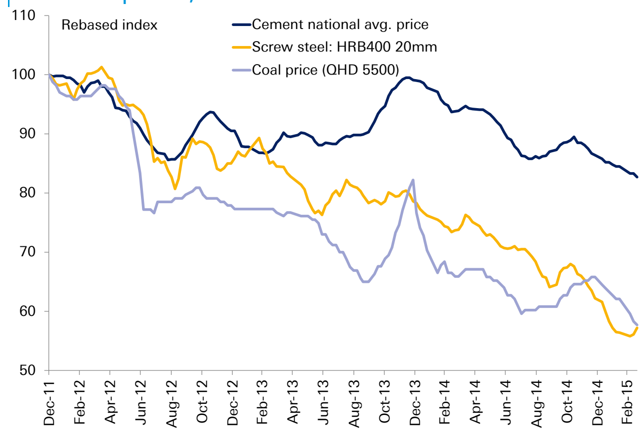
We will watch closely messages from Premier Li in the coming weeks to look for more evidence of an increasingly proactive policy stance, including at the **China Development Forum on 23 March** and the State Council Regular Meeting chaired by Li every Wednesday.

Figure 3: Coal consumption of major IPPs has been sluggish in March



Source: Wind, Deutsche Bank Strategy Research

Figure 4: Domestic commodities, including coal, cement and steel prices, fell further



Source: DigitalCement, Wind, Deutsche Bank Strategy Research

Given the above considerations, we expect **policy-easing measures to intensify in April** (see our economist Zhiwei Zhang's report Fiscal slide worsened, policy easing cycle may start soon issued on 17 March), **including monetary, fiscal and property relaxation,** helping reduce market effective interest rates and accelerate broad credit supply (M2 and TSF) over the coming months, which in turn would **raise the market's expectation of a mild economic recovery in 2H15.** Specifically, we expect:

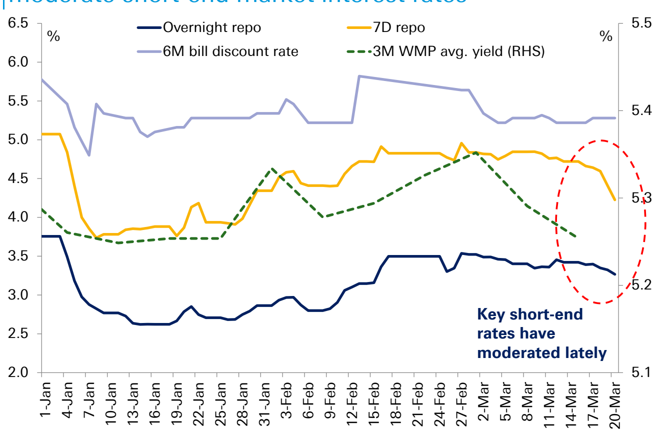
- **More monetary loosening to bring down market interest rates**
  - Our economist forecasts **a RRR cut in early April,** when March economic data become available, and **an interest rate cut in May**;
  - **We may see more liquidity injections by those newly created facilities** such as SLF, MLF, PSL etc. through open market operations; e.g. last week, the PBoC not only extended the three-month MLF (medium-term facilities) that expire on 17 March, it actually expanded their size by Rmb100-150bn to Rmb450-500bn, injecting fresh base money to the banking system and helping to lower interbank short-end rates (Figure 5);
  - The Ministry of Finance recently announced[2] it would allow Rmb1trn local government debt issuance to finance an equivalent amount of expiring LGFV liabilities in 2015. We understand direct buyers should be primarily commercial banks; however, we note that **it will be an outright base money injection if the ultimate source of money comes from the PBoC** via its liquidity facilities, such as relending window or MLF. We suspect the PBoC may be doing so because while public debt net issuance has been generally around Rmb1-2trn in recent years, **an additional Rmb1trn this year may be a too large supply increase for the**

[2] See http://www.mof.gov.cn/zhengwuxinxi/caizhengxinwen/201503/t20150312_1201705.html

banking system to handle on its own. We note that the PBoC utilized the relending window to monetize local government debt (Rmb141bn) and state-owned bank NPLs (Rmb604bn through the four AMCs) in the late 90s to stabilize the financial system and combat deflation;

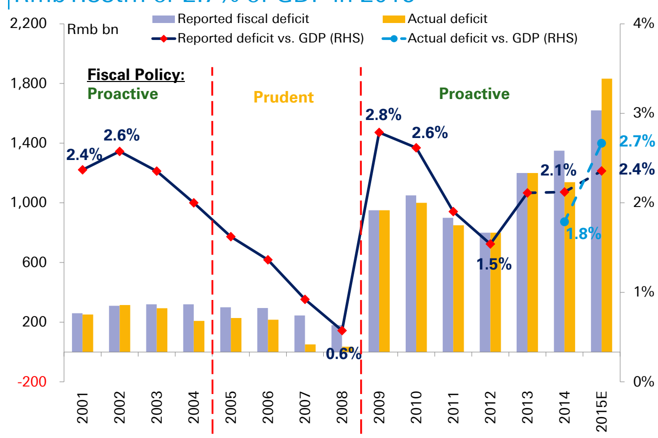
- **The monetary authority may also guide for easier credit standards** among large banks to facilitate bank loan underwriting, especially for the policy targeted areas, e.g. PPP-financed infrastructure projects, social housing projects, first-home mortgage etc.

Figure 5: Recent PBoC liquidity injections helped moderate short-end market interest rates



Source: Wind, Deutsche Bank Strategy Research

Figure 6: The effective fiscal deficit will expand to Rmb1.83trn or 2.7% of GDP in 2015



Source: Wind, Deutsche Bank Strategy Research

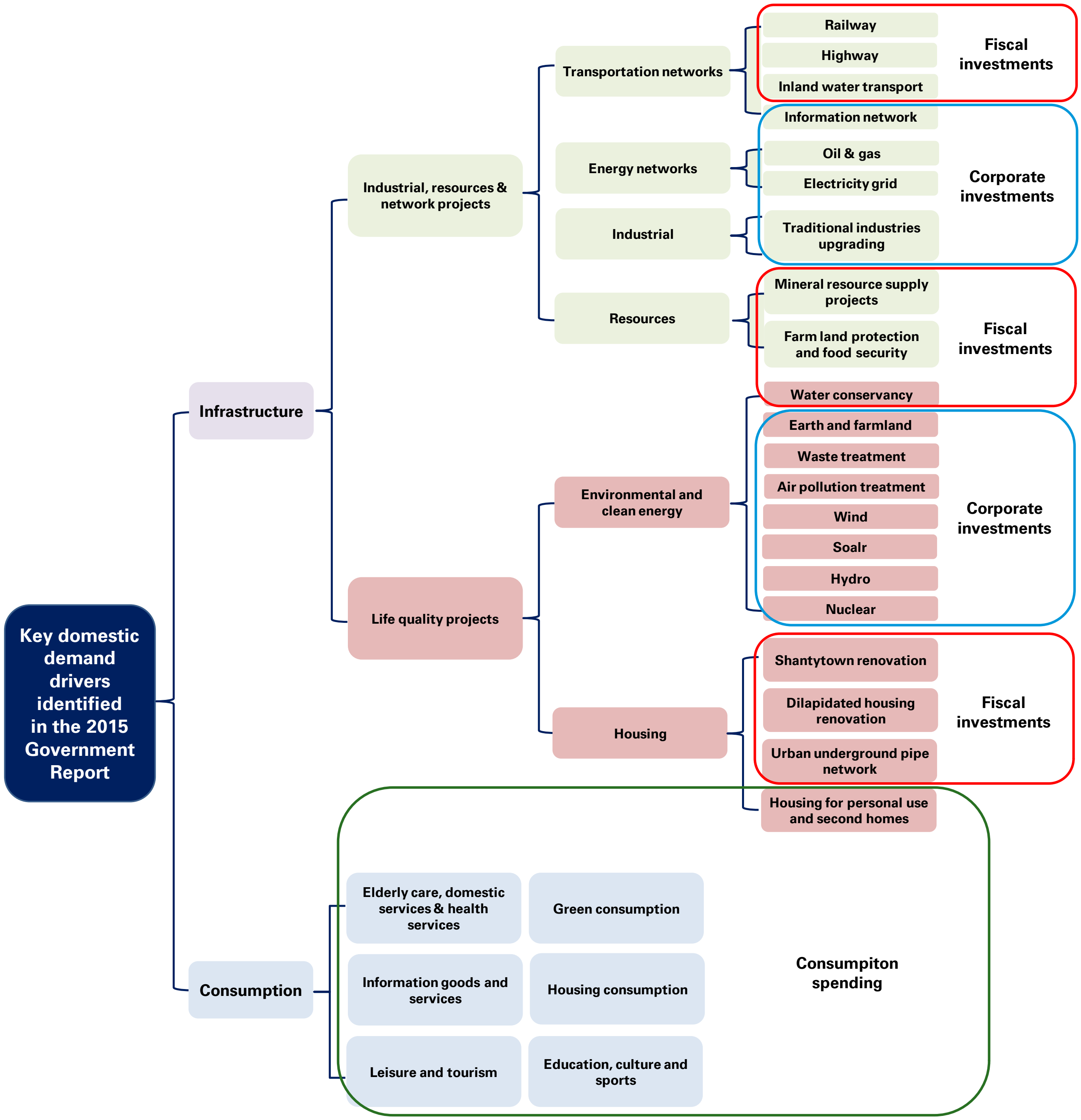
- **More expansionary fiscal stance to boost aggregate demand**
  - The 2015 Government Working Report has specifically mentioned some areas as the key demand drivers for this year, concentrating on **infrastructure investments** (industrial/energy network projects and life quality projects) and **household consumption** (information, leisure/tourism/education, housing etc.; Figure 7);
  - **Effective fiscal deficit to increase visibly:** according to of the comments made by Finance Minister Lou Jiwei at the latest press conference[3], although the documented fiscal deficit will only increase marginally to Rmb1.6trn of 2.3% of GDP in 2015 from Rmb1.35trn or 2.1% of GDP in 2014, **the effective fiscal deficit in current-year-spending terms will actually expand to Rmb1.83trn or 2.7% of GDP in 2015** from Rmb1.13trn or 1.8% of GDP in 2014 (Figure 6). If realized, we believe this more sizable fiscal deficit increase of Rmb700bn or 0.9ppt of GDP would offer stronger support to domestic demand going forward;
  - **Corporate capex will share the funding burden for infrastructure investment:** as we highlighted in Figure 7, many projects are primarily invested in by corporates instead of the government, such as network buildup (information networks, oil/gas pipelines, electricity grid), industrial upgrade, and environmental/clean energy; also, for those public projects with externalities, local

[3] See http://www.xinhuanet.com/politics/2015lh/zhibo/20150306a/

governments are proactively pushing forward the PPP (private public partnership) to involve more non-public capital;

- **Policy banks may step up funding support to designated projects:** last year the biggest policy bank, China Development Bank (CDB), was offered Rmb1trn through the PBoC's PSL (pledged supplementary lending) facility to fund social housing/shantytown renovation. This is essentially the central bank funds fiscal-backed infrastructure projects, and some market participants see it as a Chinese-type QE. We may see a similar process this year if needed.

Figure 7: Key domestic demand drivers identified in the 2015 Government Working Report



Source: 2015 Government Working Report, Deutsche Bank Strategy Research

- **More relaxation of property policies:** we expect easier mortgage standards, including a lower down-payment ratio and larger mortgage rate discount, which could **boost property sales growth and alleviate the property market's drag to economic growth in 2H15**. This is based on our recent observations, including
  - **Dovish official policy tone:** we notice the 2015 Government Working Report mentioned "support[ing] residents' self-use and

upgrading demand for housing"; this is the first time in five years we have seen a supportive policy tone on the property market in the same working plan document (Figure 8). The last time we saw this was back in 2009, when the Rmb4trn stimulus was introduced to combat the Global Financial Crisis;

Figure 8: 2015 Government Working Report shows a supportive policy tone on the property market after five consecutive years of tightening tone; last time we see this was back in 2009 when the Rmb4trn stimulus was introduced to combat the Global Financial Crisis

Year	Policy tone on the property market in the Government Working Report
2005	-Focusing on curbing the excessively rapid rise in the prices of the real estate
2006	-Continue efforts to restrict excessive real estate investment and lower overheated real estate prices in some cities -Promote the sound development of the real estate and construction industries
2007	-Promote the industry's sustained and sound growth -Strengthen oversight and regulation of housing prices, prevent overheating in housing prices & keep prices at a reasonable level
2008	-Strengthen regulation and oversight of the real estate market -Promote sustained, steady and healthy development of the real estate industry
2009	**-Promote the steady and healthy development of the real estate market** **-Adopt even more vigorous and effective policies and measures to stabilize market confidence and expectations** **-Keep real estate investment stable, and promote steady and orderly development of the real estate industry**
2010	-Promote the steady and sound development of the real estate market -Resolutely curb the precipitous rise of housing prices in some cities
2011	-Resolutely regulate the real estate market -Firmly curb the excessively rapid rise of housing prices in some cities
2012	-Continue to regulate the real estate market and develop low-income housing -Strictly implement policies and measures to discourage speculative or investment-driven housing demand -Promote long-term, steady, and sound growth of the real estate market
2013	-Tighten regulation of the real estate market and strengthen construction of government-subsidized housing -Firmly rein in speculative and investment-driven housing demand
2014	-Curb housing demand for speculation and investment purposes -Promote sustained and healthy development of the real estate market
2015	**-Support residents' self-use and upgrading demand for housing** **-Promote stable and healthy development of the real estate market**

Source: Government Working Report, Deutsche Bank Strategy Research
Note: green color refers to supportive policy tone, while red color means tightening policy tone.

- **Increasing newsflow about property policy relaxation:** we summarize in Figure 9 a list of favorable newsflow on the property market since March, including the lower down-payment ratio for HPF (housing provident fund) buyers, and a piece in *The Economic Observer* about the housing bureau, MoHURD, which is preparing to introduce measures to stabilize housing consumption, including cutting down-payments and mortgage rates for second homes[4].

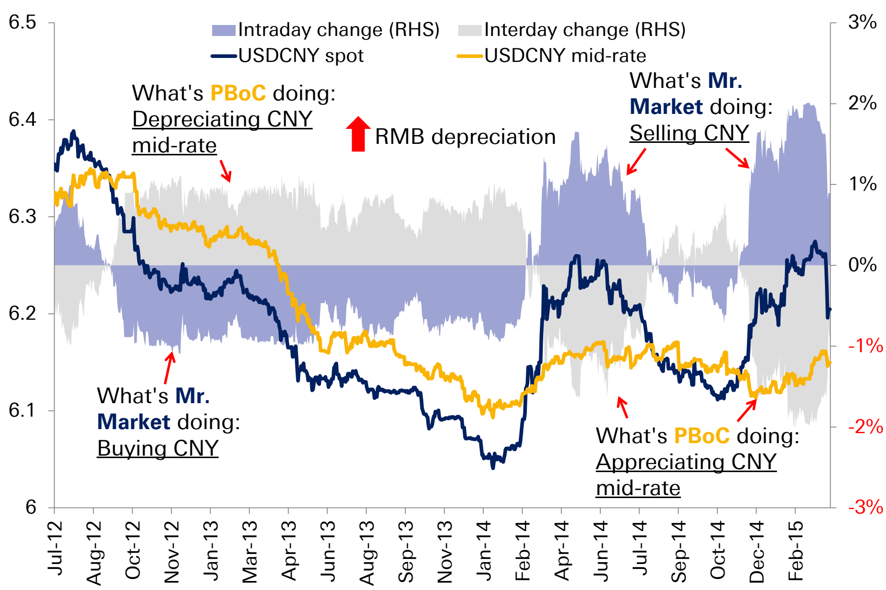
[4] See http://finance.sina.com.cn/china/hgjj/20150320/085721766719.shtml

Figure 9: We have seen favorable newsflow on the property market since March

Date	Area	News	Source
20-Mar	Nationwide	**MoHURD is reported to be mulling policies to support the property market,** including 1) lowering down-payment requirements for first-home HPF mortgages to 20%, and also lowering down-payments and mortgage rates for second-home mortgages. **Such policies have received support from MoF and PBoC**	The Economic Observer
20-Mar	Nationwide	Zhenggao Chen, Minister of Housing and Urban-Rural Development (MoHURD), said to **lower the entry requirement and expand the quota of HPF loans and streamline approvals** on a national MoHURD teleconference	Xinhua
20-Mar	Fujian province	**Fujian government lowered HPF down-payment ratio to 20%**	CNStock
19-Mar	Mutiple cities and provinces	Fuzhou, Ningbo, Sichuan, Anhui, Jiangsu, Liaoning, Inner Mongolia, Guizhou have rolled out or initiated **pilot policies to buy back commodity housing from the market for social housing use**, or have designated one SOE as the exclusive purchase entity to buy back commodity housing for relocation housing use	Caijing
16-Mar	Jinan city	**Jinan lowered the first home HPF down-payment ratio to 20%** for houses smaller than 90sqm, and 30% for houses over 90sqm, this is also applicable for second home buyers who have fully repaid their mortgage	Xinhua
5-Mar	Nationwide	Premier Li said to **support residents' self-use and upgrading housing demand** in the Government Work report in the NPC meeting	People.com
2-Mar	Xinjiang	Xinjiang issued a notice stating that, **for house buyers in the primary market, the deed tax value that exceeds 1% will be subsidized by local governments**.	Caijing

Source: Deutsche Bank Strategy Research
Note: HPF = housing provident fund.

Figure 10: PBoC has been defending the line of CNY/USD by appreciating the mid-rate (relative to last closing) in the past few months



Source: Bloomberg Finance LP, Deutsche Bank Strategy Research

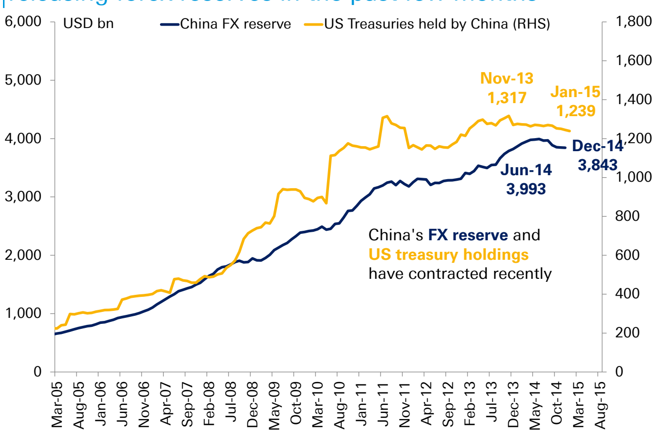
On RMB, we have been reiterating that **the currency should not depreciate significantly against USD in 2015**, and we remind readers that our economist forecast a flattish end-2015 rate of 6.2**.**

- The fact that the PBoC has been cutting rates while defending the line of CNY/USD by appreciating the mid-rate (relative to last closing) in the past few months (Figure 10) confirms the monetary authority's **clear preference for lowering interest rates to boost domestic**

demand over the depreciating RMB exchange rate to raise external demand;

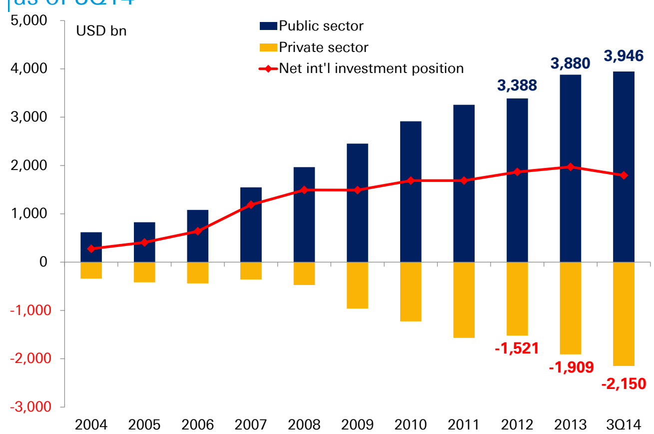
- Indeed, the PBoC has been selling US Treasury and releasing forex reserves in the past few months (Figure 11) to stabilize the CNY/USD rate**. We think this move makes sense and should sustain** as part of the global rebalancing after the Global Financial Crisis.
  - In order to stimulate Chinese exports and spur economic growth, RMB would need to depreciate against USD over 20% to catch up with the pace of EUR and JPY. We think this will **cause notable trade friction events and may not be able to effectively help Chinese exports** considering China is already the world's largest trader and there is still sluggish DM demand;
  - Chinese corporates have accumulated a big chunk of USD/HKD-denominated debt in the past few years, taking advantage of the cheap USD funding costs and what essentially constitutes a carry trade. Allowing RMB to depreciate in a big way would **significantly increase the financial costs for these companies**, especially property developers, construction contractors, airlines etc., and **may incur self-propelling funds outflows** as the Chinese private sector increases demand for USD to match their liabilities, which stood at US$2.15trn at September 2014 (Figure 12).

Figure 11: The PBoC has been selling US Treasury and releasing forex reserves in the past few months



Source: Wind, Deutsche Bank Strategy Research

Figure 12: Chinese private had US$2.15trn forex liability as of 3Q14



Source: SAFE, Deutsche Bank Strategy Research

Earnings cut cycle to come to an end by April

Flash FY14 results: 40% cap reported; results slightly below expectations

So far 40% market cap of our H-share universe (or 50% in the non-financial space) has reported FY14 earnings. **The results are slightly below expectations,** as overall FY14A bottom-line growth registered a yoy decline of 2.2%, compared to the -0.7% expected by consensus; non-financials saw earnings decline 6.3% yoy, 1.8% worse than market consensus of -4.5%.

Sector-wise, **telcos** have completed reporting and saw profits drop 7% yoy, but this was 2% better than consensus. 74% market cap of **IT companies** have reported 39% aggregated earnings growth, largely in line than consensus. With roughly 30% of **consumer** companies announcing results, the overall surprise was tilted to the downside, as the 15% and 24% profit declines in discretionary and staples were both below consensus by 5% and 9% respectively. The reporting of marine and utilities so far has appeared to be notably missing consensus by 15% and 17% respectively. Other sectors have reported too little market cap to be conclusive. Grouping-wise, cyclicals, SOEs, old-economy and upstream sectors have generally missed consensus estimates, while private and downstream sectors have reported higher-than-consensus results. See our summary in Figure 13.

See our preview at FY14 Earnings Preview - Midstream to beat, upstream and consumers to miss.

Figure 13: H-share FY14 results flash: 40% of market cap has completed reporting

	Mkt cap reported	Net income growth 2013A	1H14	2014A	Surprise vs. consensus	2014E	2015E
Consumer Discretionary	**30%**	**36%**	**-1%**	**-15%**	**-5%**	**-10%**	**27%**
Consumer Staples	**33%**	**-3%**	**-3%**	**-24%**	**-9%**	**-17%**	**13%**
Energy	**26%**	**-7%**	**-6%**	**-25%**	**-9%**	**-18%**	**-24%**
Financials	**15%**	**20%**	**13%**	**9%**	**4%**	**5%**	**10%**
Banks	5%	22%	13%	6%	-0%	6%	8%
Diversified Financials	8%	93%	116%	46%	2%	42%	27%
Insurance	37%	44%	20%	39%	-1%	40%	14%
Real Estate	27%	8%	6%	-3%	16%	-17%	8%
Health Care	**19%**	**9%**	**11%**	**25%**	**-3%**	**29%**	**14%**
Industrials	**16%**	**6%**	**27%**	**31%**	**-1%**	**32%**	**31%**
Capital Goods	15%	8%	10%	29%	-0%	30%	47%
Commercial & Professional Services	3%	10%	-26%	-14%	-28%	19%	12%
Airlines	0%	N/M	N/M	N/M	N/M	N/M	N/M
Marine	67%	-9%	28%	13%	-15%	33%	21%
Road & port	12%	18%	95%	61%	16%	39%	-9%
Information Technology	**74%**	**78%**	**50%**	**39%**	**-1%**	**40%**	**28%**
Materials	**21%**	**24%**	**14%**	**-14%**	**-13%**	**-2%**	**11%**
Telecommunication Services	**99%**	**2%**	**-4%**	**-7%**	**2%**	**-9%**	**8%**
Utilities	**39%**	**26%**	**6%**	**-3%**	**-17%**	**17%**	**13%**
Overall	**40%**	**10.9%**	**6.0%**	**-2.2%**	**-1.5%**	**-0.7%**	**7.4%**
Non-financials	**50%**	**7.5%**	**3.4%**	**-6.3%**	**-1.8%**	**-4.5%**	**6.5%**
Cyclicals	39%	10%	7%	-6%	-2%	-4%	5%
Defensives	72%	4%	-2%	-7%	-2%	-6%	9%
Financials	12%	27%	15%	14%	-0%	14%	10%
SOE (ex. Financials)	51%	2%	-1%	-11%	-4%	-8%	0%
Private (ex. Financials)	50%	22%	15%	5%	2%	3%	19%
New Economy (ex. Financials)	56%	64%	41%	32%	-1%	34%	25%
Old Economy (ex. Financials)	48%	3%	-1%	-12%	-2%	-10%	3%
Upstream	22%	-10%	-6%	-24%	-9%	-17%	-24%
Mid-stream	24%	67%	29%	17%	-8%	27%	22%
Downstream	66%	9%	3%	-3%	2%	-5%	14%

Source: Bloomberg Finance LP, Deutsche Bank Strategy Research

Earnings cut cycle to come to an end; look for margin-driven recovery

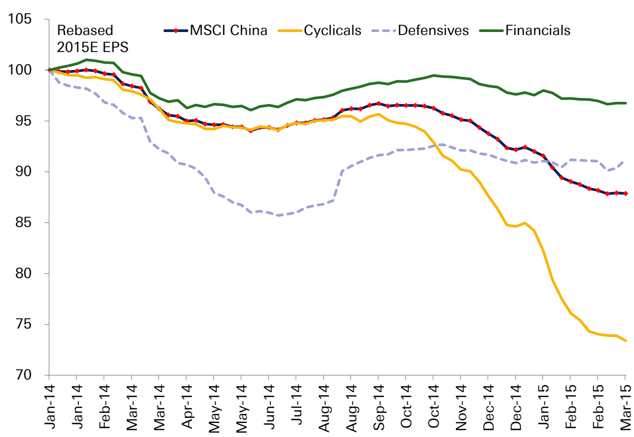
MSCI China 2015E consensus EPS has been stabilizing recently, especially for financials and defensives (Figure 14). **We believe the earnings cut cycle will come to an end by April**, as the FY14 results season wraps up and consensus estimates move closer to our top-down forecasts.

For FY15, we look for more evidence of cost reduction to reaffirm our expected margin-driven earnings recovery in non-financials. We reiterate our forecast that **overall H-share earnings may grow 4.7% and 5.1% in 2015 and**

2016, respectively (Figure 16**)**; non-financials' earnings growth will likely accelerate to 6.5%/7.5%, driven mainly by non-financial profit margin expansion, while financials may see only 3% growth in 2015/16 on the back of narrower NIM and slower M2 growth.

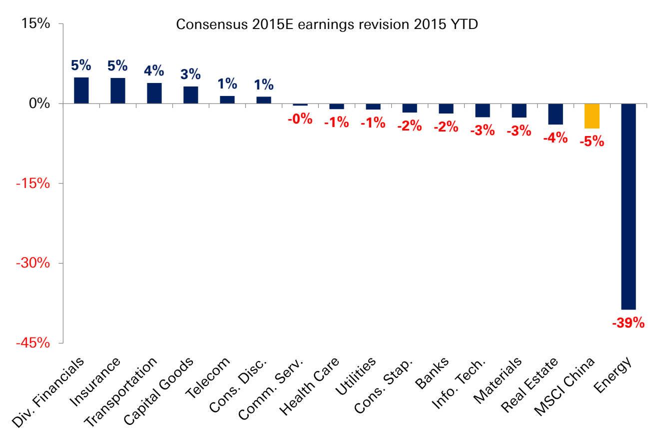
Watch for the latest consensus earnings revision trend: on an YTD basis, non-bank financials (+5%), transportation (+4%) and capital goods (3%) have been receiving 2015E earnings upgrades. Upstream sectors saw their earnings down by 39% and 3% for energy and materials respectively (Figure 15).

Figure 14: 2015 consensus stabilized recently, especially for defensives



Source: Bloomberg Finance LP, MSCI, Deutsche Bank Strategy Research
Note: Historical values are calculated on current constituents

Figure 15: Non-bank financials and select industrials received the most earnings upgrades



Source: Bloomberg Finance LP, MSCI, Deutsche Bank Strategy Research
Note: Historical values are calculated on current constituents

Figure 16: We look for non-financial earnings growth to recover to 6.5% in 2015 at the expense of financials; overall H-share may deliver 4.7% growth

DB Forecasts vs. Consensus		Sales Growth	Net Margin	Earnings Growth	Consensus Earnings Growth	Implied Revisions
2014E	Non-financials	4.5%	6.3%	-1.8%	-1.4%	-0.4%
	Financials			8.0%	8.8%	-0.7%
	H-share			**3.3%**	**3.9%**	**-0.6%**
2015E	Non-financials	4.0%	6.4%	6.5%	7.1%	-0.6%
	Financials			3.0%	7.1%	-3.9%
	H-share			**4.7%**	**7.1%**	**-2.3%**
2016E	Non-financials	5.0%	6.6%	7.5%	21.4%	-11.5%
	Financials			3.0%	9.8%	-6.2%
	H-share			**5.1%**	**15.1%**	**-8.7%**

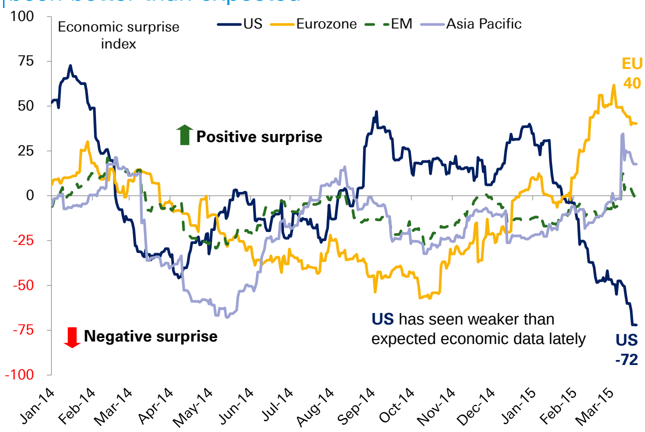
Source: Bloomberg Finance LP, Deutsche Bank Strategy Research

Global funds may flow in to catalyze a catch-up with A-shares

Fed signaled more dovish than expected stance; we see fund inflows ahead

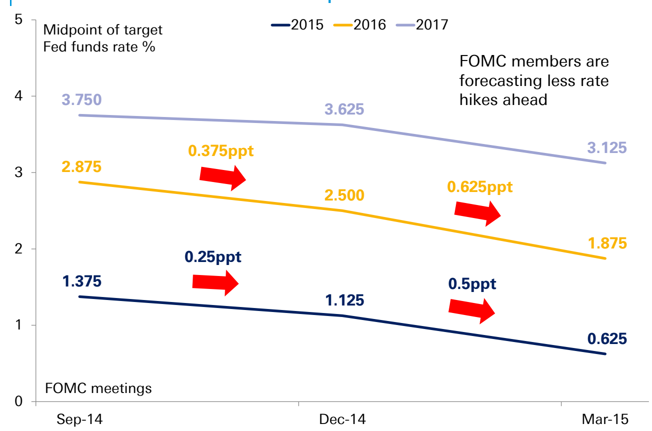
Given the weaker-than-expected economic growth so far in the US (Figure 17), the Fed joined forces with other major global central banks (Figure 19) on the dovish side and suggested “lower for longer” rates over the coming quarters. We think this could boost global liquidity conditions and support risk appetite. **We expect H-shares to catch up with A-shares thanks to global fund inflows.**

Figure 17: Recent economic data in the US have been weaker than expected, while those of EU and EM have been better than expected



Source: Bloomberg Finance LP, Deutsche Bank Strategy Research

Figure 18: The median Fed funds rate target of 2015 was cut 50bps to 0.625%, 2016 was cut 62.5 bps to 1.875% and 2017 was reduced 50 bps to 3.125%



Source: Federal Reserve, Deutsche Bank Strategy Research

Figure 19: A summary of monetary loosening actions by major central banks in 2015

Date	Country /region	Major central banks' loosening actions 2015 YTD	Date	Country /region	Major central banks' loosening actions 2015 YTD
18-Mar	**USA**	**March FOMC statement lowered median fed funds rate projection and the possibility of a June 2015 liftoff**	4-Feb	Romania	Cuts policy rate by 25bps to 2.25%
18-Mar	Sweden	Cuts repo rate by 15bps to -0.25%	**4-Feb**	**China**	**Cuts RRR by 50bps to 19.5%**
18-Mar	**China**	**It is reported that PBoC renewed c.RMB500bn MLF**			
12-Mar	S. Korea	Cuts base rate by 25bps to 1.75%	3-Feb	Australia	Cuts cash rate by 25bps to 2.25%
11-Mar	Thailand	Cuts repo rate by 25bps to 1.75%	30-Jan	Russia	Cuts key rate by 200bps to 15%
4-Mar	Poland	Cuts reference rate by 50bps to 1.5%	**22-Jan**	**Eurozone**	**Expands purchases to include bonds issued by euro area central governments, agencies and European institutions; combined monthly asset purchases to amount to €60 billion**
4-Mar	India	Cuts policy repo rate by 25bps to 7.5%	21-Jan	Canada	Cuts target overnight rate by 25bps to 0.75%
28-Feb	**China**	**Cuts benchmark lending rate by 25bps to 5.35%**	20-Jan	Turkey	Cuts repo rate by 50bps to 7.75%
24-Feb	Turkey	Cuts repo rate by 25bps to 7.5%	19-Jan	Denmark	Cuts lending rate by 15bps to 0.05%
23-Feb	Israel	Cuts benchmark rate by 15bps to 0.1%	15-Jan	Peru	Cuts policy interest rate by 25bps to 3.25%
17-Feb	Indonesia	Cuts benchmark rate by 25bps to 7.5%	15-Jan	Switzerlan	Cuts target range to -1.25% ~ -0.25%
12-Feb	Sweden	Cuts repo rate by 10bps to -0.1%	15-Jan	India	Cuts policy repo rate to 7.75%

Source: Deutsche Bank Strategy Research

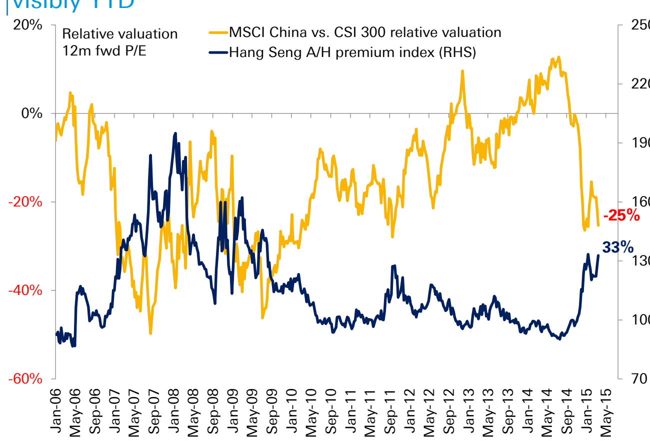
- FOMC made two important changes to its March statement, as our US economist Joseph LaVorgna highlighted:
  - The removal of the date-dependent forward guidance (the “patient” language”) and the much lower than projected median Fed funds dots. Specifically, the median **Fed funds rate target of 2015 was cut 50bps to 0.625%, 2016 was cut 62.5 bps to 1.875%** and 2017 was reduced 50 bps to 3.125% (Figure 18). **This indicates that a June rate hike is not very likely, and the Fed is currently aiming for September liftoff followed by another rate hike later this year.**
  - **The Fed is clearly worried about strengthening dollar by saying “export growth has weakened”.** See their note in Fed "dot plot" points to September liftoff with shallower glide path, 18 March 2015.

- We believe the much lowered "dots" by FOMC members in the March 18 vs. the previous two meetings implies a delayed initial rate hike and slower pace of hikes after the lift-off, which should lend support to global liquidity conditions and raise investor risk appetite. **We expect global fund inflows to H-shares to catch up with A-shares:**
  - **A-share have been outperforming H-shares significantly YTD.** This is not surprising to us, as we have been reiterating that the key overhang for the H-share market in 2015 is the fund outflows amid the tightening Fed monetary stance, and expected continued A-share outperformance based on our expectations of the loosening PBoC vs. the tightening Fed (see the liquidity section on pages 29-36 in 2015 China Outlook);
  - Now with ECB initiating QE since March, more and more central banks cutting interest rates, and the Fed finally signaling a more dovish monetary stance (Figure 18), we expect the asset market to reflect these increasingly more accommodative global liquidity conditions going forward, and for Chinese equities, **we expect H-shares to catch up with A-shares as global funds start to flow in** to gain from our expected improving cyclical outlook and expediting reform in China.
- On the domestic side, our economists expect a cut of RRR by 50bp in early April, when March economic data become available to policy makers, as well as another interest rate cut in May.

Still deeply discounted valuations suggest light investor positions

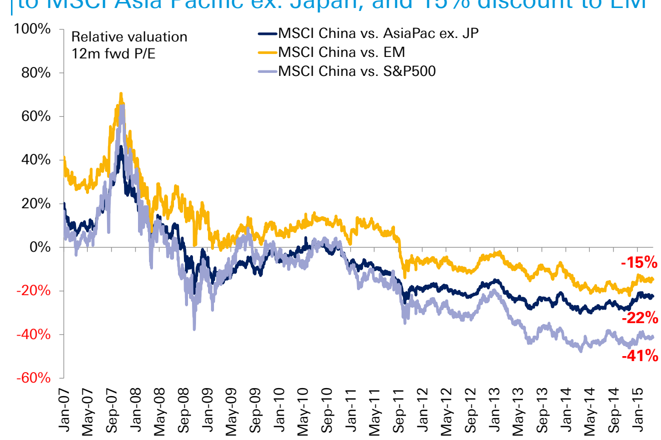
H-shares are still trading at deeply discounted valuations in cross-country terms and compared to their own history. Currently MSCI China is trading at 10.1x 12m fwd P/E, a 25% discount to A-shares (Figure 20), 22% discount to Asia Pacific ex. Japan and 15% discount to EM (Figure 21). Compared to their own history and cross-markets, H-shares' present 15% valuation discount to its 10-year average of 11.9x still looks appealing (Figure 22-Figure 23).

Figure 20: A-shares have been outperforming H-shares visibly YTD



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

Figure 21: MSCI China currently trades at 22% discount to MSCI Asia Pacific ex. Japan, and 15% discount to EM

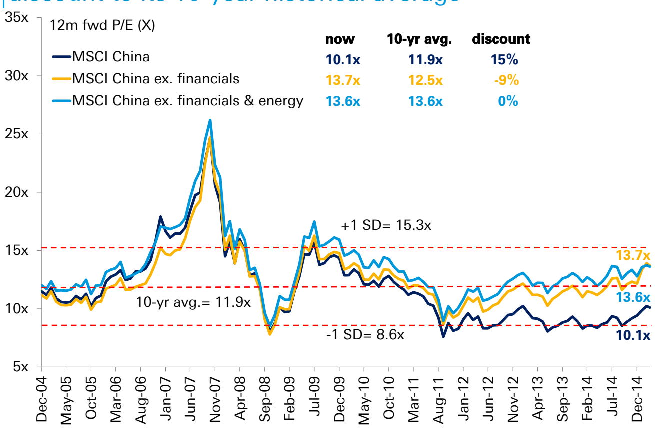


Source: Bloomberg Finance LP, MSCI, Deutsche Bank Strategy Research

Looking at the stock market capitalization rate (domestic market capitalization divided by country/regional GDP), **China's stock market cap still has ample room to grow** given its current 76% capitalization rate (including A-shares, Bshares and all offshore listings), compared to 114% in Japan, 142% in India, and 146% in the US (Figure 24).

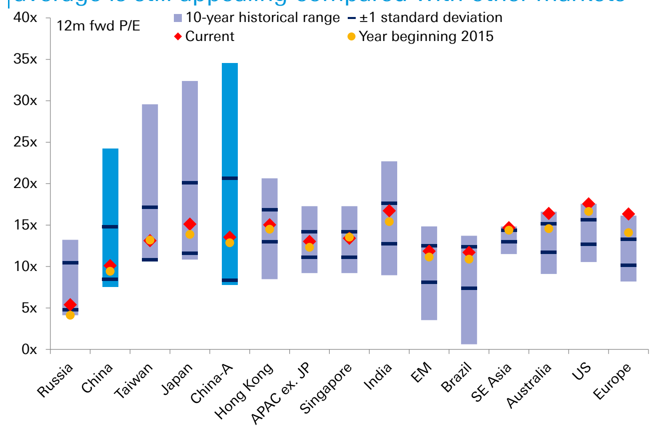
Based on our four-phase analytical framework outlined on pages 41-42 of our 2015 China Outlook, we think H-shares have entered the "optimism" phase with rising EPS and expanding P/E from the "hope" phase, where index returns are solely driven by valuation re-rating (Figure 25). We believe **potential global funds inflow ahead may help extend H-shares in the "optimism" phase** and send the index higher.

Figure 22: MSCI China now trades at 10.1x, or a 15% discount to its 10-year historical average



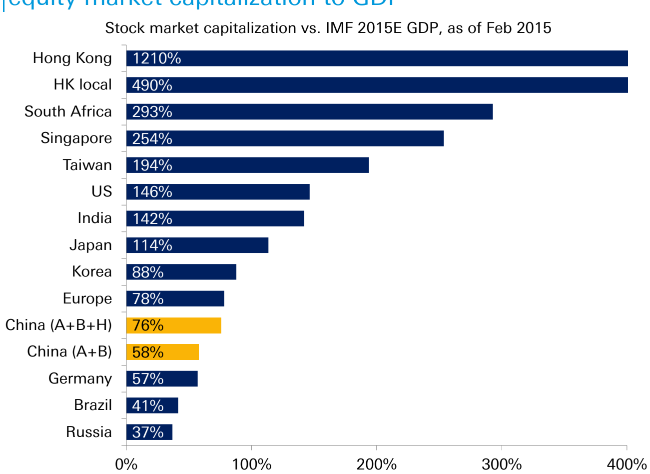
Source: Bloomberg Finance LP, MSCI, Deutsche Bank Strategy Research

Figure 23: H-shares' 15% valuation discount to its 10-yr average is still appealing compared with other markets



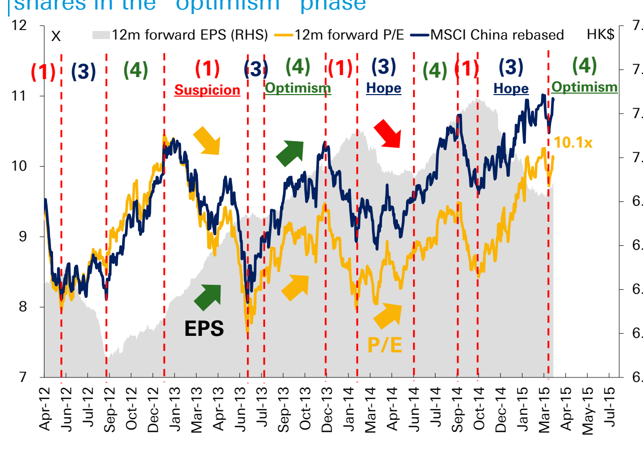
Source: Bloomberg Finance LP, MSCI, Deutsche Bank Strategy Research

Figure 24: China still has ample room to grow the ratio of equity market capitalization to GDP



Source: Bloomberg Finance LP, WFE, Wind, Deutsche Bank Strategy Research
Note: China (A+B+H) comprises all onshore and offshore listed Chinese stocks

Figure 25: We think fund inflows may help extend H-shares in the "optimism" phase



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

Chinese reform to expedite in 2015

We expect reform to accelerate in 2015 and suggest investors focus on:

- **SOE reform:** asset injection and SOE securitization may expedite next year, given tighter local government fiscal conditions and their ambitious securitization targets;

- **"Go Global":** China's grand One Belt One Road strategy will bring more infrastructure projects and benefit related construction materials, machinery, railway and utilities sectors, etc.;
- **Financial reform:** further interest rate liberalization bodes ill for bank earnings; brokers are set to benefit from capital market reform and the potential SZ-HK Connect;
- **Fiscal & tax reform:** the expansion of VAT reform to property and financial services in 2015 will likely raise their tax burden, but winners will be services sector and SMEs. We may see tighter implementation of existing tax, such as sales tax in e-commerce business;
- **Land & Hukou reform:** a critical and long-term step to improve China's growth potential and facilitate the New Urbanization campaign. Short-term beneficiaries will be companies with rural land bank.

See more detailed analysis on pages 65-76 of our 2015 China Outlook.

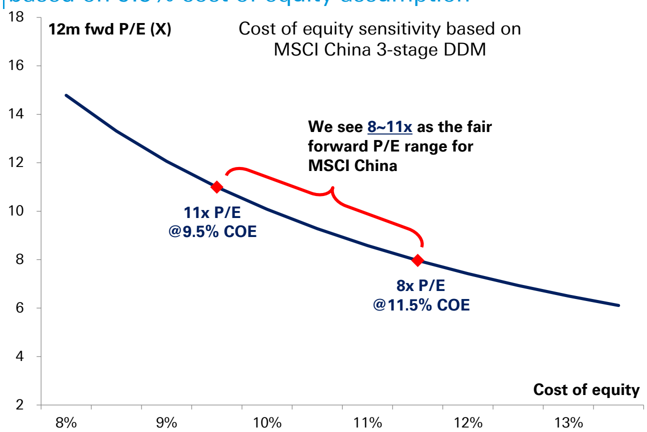
Raising index target

Raising index target on lower cost of equity assumptions

We raise our end-2015 index target for MSCI China to 80.3 based on 11x 12-month forward P/E and 5% earnings growth, **implying 15% upside from here. Our end-2015 target for HSCEI is also revised up to 14,000**.

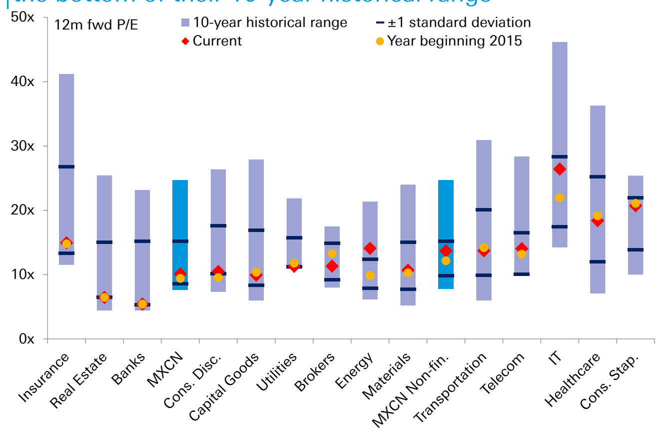
The MSCI China index valuation target of 11x 12-month forward P/E is derived from our three-stage dividend discount model and based on the assumption of 9.5% cost of equity (3.2% 10-year Chinese government bond yield and 6.3% equity risk premium). See Figure 26.

Figure 26: Our three-stage DDM suggest 11x target P/E based on 9.5% cost of equity assumption



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

Figure 27: Insurance, property and banks are trading at the bottom of their 10-year historical range



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

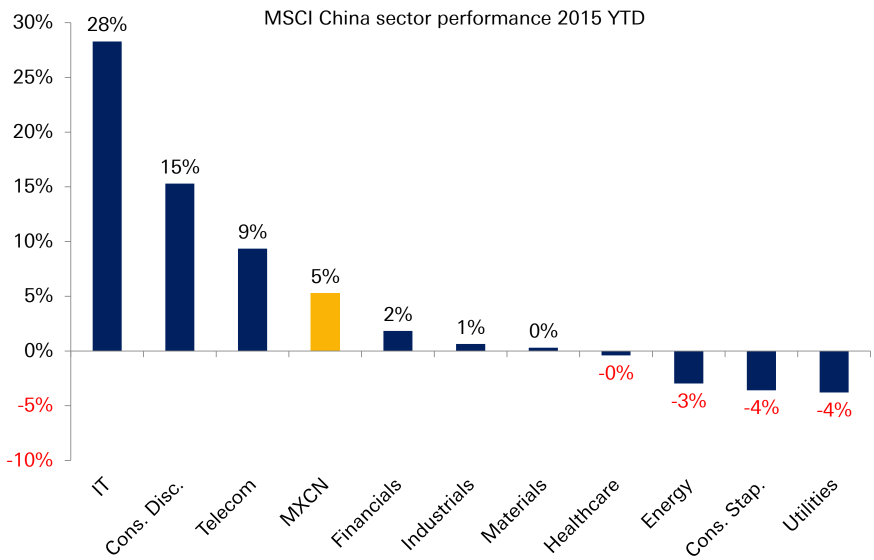
Upgrading property to OW & banks to MW while downgrading health care to MW

We upgrade property to overweight (OW) from market-weight (MW) and suggest sticking to bellwethers, including COLI (688 HK), Vanke (2202 HK) and CR Land (1109 HK), as we see better risk/reward there than at smaller developers. Property market demand may see improvement on the back of further loosening measures, including lower down-payment ratios, further benchmark rate cuts and tax subsidy, etc. Our property analyst Tony Tsang and his team expect a short-term cyclical recovery in 2015 in the physical residential market with a gradual ASP recovery in 2H15. Coupled with volume recovery, developers may see an improving top line. On the cost side, the sector also benefits from the down-trending cost of financing and commodity prices. **The sector is trading at the bottom of its 10-year historical P/E range (Figure 27).**

We also upgrade banks to MW from underweight (UW), due primarily to: **1)** we see improved risk/reward after financials' YTD underperformance (3ppt relative to MSCI China; Figure 28), and banks now trade at an undemanding valuations of 0.2 std below the 5-yr average 12m trailing P/B; **2)** MoF's RMB 1trn local government debt transformation scheme lowered the probability of imminent credit events around local government vehicles, reducing the perceived asset quality risks; the program will also help boost banks' ROE, as commented on by our analyst Tracy Yu; **3)** upcoming policy loosening and subsequently improving cyclical macro outlook may further alleviate asset quality concerns.

We maintain our OW recommendation on insurance and brokers and upgrade the overall financials as OW from MW. Other top picks in the space include Ping An (2318 HK) and CITIC Securities (6030 HK).

Figure 28: Financials underperformed MSCI China by 3ppt YTD; IT and discretionary outperformed



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

On the consumption and services space, we continue to **overweight info. tech. while downgrading healthcare to market-weight.** Healthcare's growth may decelerate as the release of the State Council's final version of the drug tender guidelines may bring more price cuts, according to our analyst Jack Hu, who also sees sector volatility extending for at least few more months until 1) the majority of the large provinces complete RDL drug tenders; 2) executives take down guidance for 2015; 3) there is downward revision of sell-side consensus. **We keep our market-weight suggestion on consumer discretionary and staples, and underweight telecom**. Our favorite name is Baidu (BIDU US).

On industrials, **we are positive on mid-stream sectors including utilities, construction and cement**, with top picks such as CPI (2380 HK), CRCC (1186 HK) and BBMG (2009 HK), while we **stay cautious on upstream, including energy and metal mining.** See our updated sector preference table in Figure 29.

Following our changes of sector preference, we add **China Construction Bank (939 HK) to our top-10 picks, replacing CSPC Pharm. (1093 HK).** As one of our sector analyst's top picks, CCB has a strong competitive edge in financing infrastructure-related (26.5% of total loans) and mortgage loans (22.7%). Our analyst Tracy Yu expects **CCB to benefit the most from accelerating infrastructure spending** and as CCB's assets are more easily securitized, making it a key beneficiary of further growth in China's ABS and MBS markets. Amongst the listed banks, CCB enjoys one of the highest levels of profitability, as suggested by its high ROAA of 1.39% in 2014, on our estimates. The stock is trading at an attractive 0.9x consensus 15E P/B with 19% ROAE and 6.5% dividend yield. Our target price of HKD8.2 implies 26% upside potential from its HKD6.48 closing price on 20 March 2015. See our top-10 picks in Figure 30.

Thematic ideas and stock screens

Thematic-wise, we focus on **1) cost savers** (buy property, power and cement, sell energy and metal mining), **2) top-line growers** (buy internet/software and travel/leisure, sell retail and F&B), **3) reform beneficiaries** (buy insurance, brokers and railway), **4) MSCI inclusion** (buy internet/software, sell financials, energy and telecom), and **5) resilient RMB** (buy outbound consumer services, sell exports & HK retail/landlords).

For the single stock names we highlighted, please see Figures 166-170 in 2015 China Outlook: Rate-cut, reform & re-rating in the Year of the Ram, 5 Jan 2015, and Figures 6-7 in China Strategy Stock Screens – Trading Euro weakness in HK/China equities, 11 Mar 2015.

Figure 29: We suggest overweight financials, info. tech., industrials and utilities and underweight telecom and energy

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**	40%	43%	3%	6.9	1.0	0.2	Insurance Diversified Financials Real Estate	Banks	
	Info. Tech.	15%	18%	3%	26.4	2.5	1.6	Internet & Software	Hardware & Semicon	
	Industrials	7%	9%	2%	11.2	1.3	0.4	Capital Goods	Transportation	
	Utilities	4%	6%	2%	11.3	0.9	-0.8	IPPs Water/Gas/Renew.		
Market-weight (MW)	**Cons. Disc.**	5%	5%	0%	10.8	1.7	-0.3		Automobiles Retailing & Others	
	Cons. Stap.	4%	4%	0%	20.8	1.3	-0.8		Food & Beverage Household Products	
	Health Care	2%	2%	0%	18.3	1.7	-0.2		Health Care	
	Materials	2%	2%	0%	10.7	1.0	0.6	Construction Materials		Other Basic Materials
Under-weight (UW)	**Telecom**	11%	6%	-5%	14.0	3.9	2.3			Telecom
	Energy	10%	5%	-5%	14.2	1.3	4.6			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 who are based on 12-month trailing P/B.

Figure 30: Deutsche Bank 2015 China top-10 picks: replacing CSPC Pharm (1093 HK) with CCB (939 HK)

DB 2015 China Top-10 Picks								Themes				Consensus Estimates (calendarized)						DB Rating		
Ticker	Company Name	GICS Sector	Price Mar 20 (LOC)	Shr-class Mkt Cap (USDm)	3M ADT (USDm)	5-yr Beta MXCN	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	Upside Potential
2318 HK	Ping An	Financials	92.10	44,219	290	1.2		√	√		13.9	2.1	16%	1.1%	8%	13%	**Buy**	108.0	17%
688 HK	COLI	Financials	22.20	23,396	69	1.1	√				7.0	1.2	19%	2.8%	15%	15%	**Buy**	30.0	35%
6030 HK	Citic Securities	Financials	27.25	4,140	62	1.3		√	√		20.6	2.2	12%	1.6%	20%	17%	**N/A**	N/A	N/A
1186 HK	CRCC	Industrials	9.87	2,642	24	1.1		√	√		8.0	1.0	13%	1.9%	7%	9%	**Buy**	10.3	5%
2009 HK	BBMG	Materials	6.58	992	8	1.3	√	√	√		7.0	0.7	11%	1.7%	10%	5%	**Hold**	7.0	7%
BIDU US	Baidu	Info. Tech.	212.69	58,661	633	0.7		√		√	26.8	6.6	28%	0.0%	23%	35%	**Buy**	249.0	17%
2380 HK	China Power Int'l	Utilities	3.85	3,457	12	0.7	√		√		7.1	0.9	13%	5.6%	3%	4%	**Buy**	4.7	22%
371 HK	BEWG	Utilities	4.88	5,479	15	0.9		√			19.4	2.6	14%	1.8%	33%	23%	**Buy**	6.6	35%
816 HK	Huadian Fuxin	Utilities	3.38	1,120	9	0.7	√	√			8.5	1.3	16%	2.4%	33%	22%	**Buy**	6.1	80%
Addition																			
939 HK	CCB	Financials	6.48	200,864	214	1.0					5.3	0.9	19%	6.5%	5%	8%	**Buy**	8.2	26%
Deletion																			
1093 HK	CSPC Pharm	Health Care	6.42	4,890	10	0.8		√			22.4	4.0	19%	1.3%	31%	28%	**Buy**	8.5	32%
			Equal weight	**34,497**	**134**	**1.0**					**12.3**	**2.0**	**16%**	**2.5%**	**16%**	**15%**			**27%**

Source: Bloomberg Finance LP, Deutsche Bank Strategy Research
Note: In themes, C refers to cost savers, T refers to top-line growers, R refers to reform beneficiaries, and M refers to MSCI inclusion
Deutsche Bank coverage of Citic Securities (6030 HK) is temporarily suspended due to team structure change

Appendix 1

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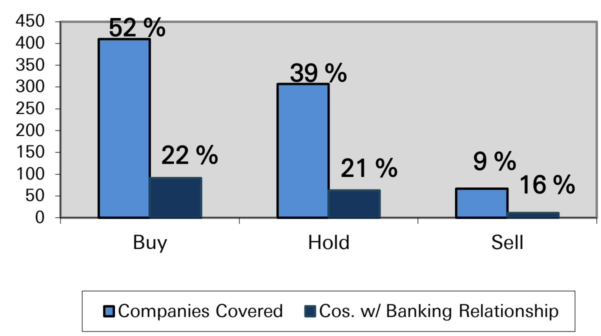

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