Asian Equity Strategy: China Overweight

H shares up 19% from lows; still cheap?

Sakthi Siva / Research Analyst / 65 6212 3027 / sakthi.siva@credit-suisse.com
Kin Nang Chik / Research Analyst / 852 2101 7482 / kinnang.chik@credit-suisse.com

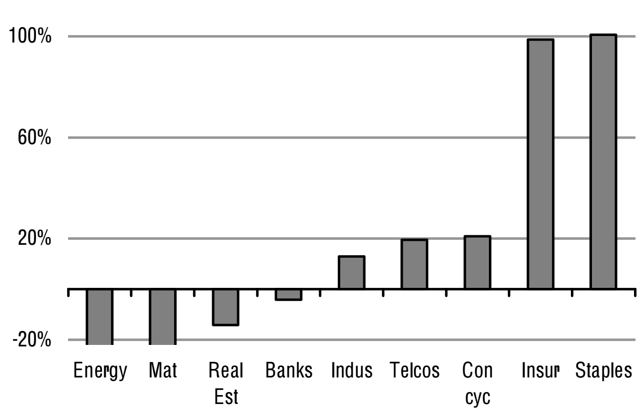
- Even with the H shares up almost 19% in two days from its lows, our Six Factor Hang Seng Valuation Indicator is still 20% undervalued.
- Since the model began in 1993, the Hang Seng Six Factor has only been cheaper on three previous occasions – 40% undervalued during the 1998 Asian financial crisis, 25% undervalued during the SARS episode in April 2003 and 28% undervalued on 17 September 2008.
- Within MSCI China, the most undervalued sectors on our P/B vs ROE valuation model are energy (27% discount), materials (23% discount), real estate (14% discount) and banks (4% discount). Of our "crowded" trades, Chinese staples still trade at a 101% premium to the region, but the telcos have fallen to a 20% premium.
- While we think consensus EPS revisions are a lagging indicator, we continue to be surprised by the resilience of banks' consensus EPS. So far in September, 2008E banks' consensus EPS is +0.2% (YTD +17.7%) and 2009E is -0.9% (YTD +10.9%).

Hang Seng Six Factor Valuation Indicator still 20% undervalued

Despite the sharp rally in H shares (Hong Kong listed Chinese shares) in the last two days, our Six Factor Hang Seng Valuation Indicator is still 20% undervalued – and still in "buy" territory, as the "buy" signal is at 12% undervalued (we hit the "buy" signal on 21 August).

So if China is still cheap, the next question is which sectors look particularly undervalued? Figure 1 highlights that the four most undervalued sectors are energy, materials, real estate and banks. In contrast, our "crowded" trades of consumer staples still trade at a 101% premium to the region but telecoms' premium has dropped to just 20%.

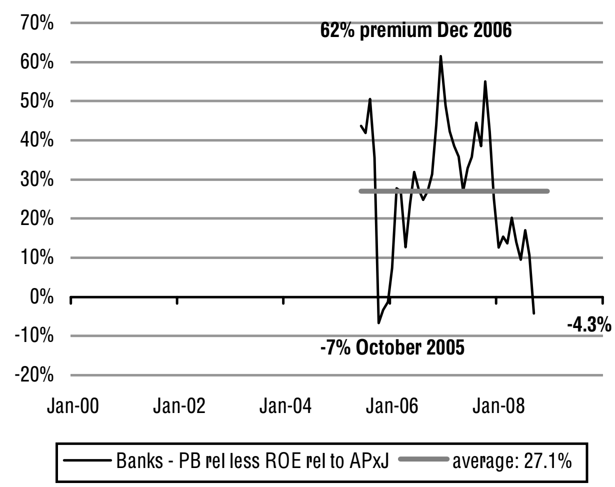
Figure 1: Chinese sectors P/B vs ROE relative to the region



Source: Company data, Credit Suisse estimates.

The 4% discount that Chinese banks are trading at is the cheapest the sector has got to, except for the 7% discount seen in October 2005. But history is short, as the Chinese banks only listed in mid-2005.

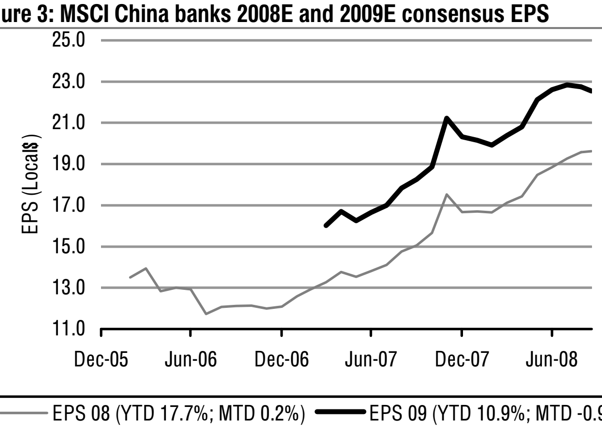
Figure 2: Chinese Banks P/B vs ROE relative to the region



Source: Company data, Credit Suisse estimates.

While we think consensus EPS revisions are a lagging indicator, we continue to be surprised by the resilience of Chinese banks consensus EPS. Figure 3 highlights that 2008E consensus EPS for Chinese banks was revised up by 0.2% so far in September and by 18% so far this year. 2009E consensus EPS have so far been revised down by 0.9% in September. For 2008E consensus EPS, China banks have the strongest YTD upgrades compared with +15% for staples and +8% for telecoms and yet the banks are so much cheaper.

Figure 3: MSCI China banks 2008E and 2009E consensus EPS



Source: IBES, Credit Suisse estimates.