Strategy Report

Start of the end of the pandemic?

The COVID-19 vaccine candidate by Pfizer and BioNTech has shown promising results in first interim analysis, giving a big boost to economic and corporate earnings outlook. We believe a sector rotation from growth to value is likely, and this rotation would last longer than previous ones. Buy beaten-down "reopening" sectors selectively, and reflationary plays.

- **Huge boost for cyclical stocks.** While news of good progress in vaccine development is positive for the stock market in general, we expect cyclical / old-economy stocks which are most sensitive to economic cycles to enjoy the biggest rally. New-economy stocks, having significantly outperformed since the outbreak, and with valuation premium over old-economy stocks at decades-high, may face profit-taking.
- **Sector rotation could last for longer this time.** Value stocks did outperform for several times this year during sector rotations, but each one did not last long, due to a lack in fundamental changes and resurgences in COVID-19 cases. This time can be different, thanks to the encouraging progress in vaccine development and therefore better outlook in recovery of the economy and corporate earnings.
- **Growth stocks turning weak, value stocks improving.** In HK market, Relative Rotational Graph (RRG) shows that growth sectors such as Healthcare, Consumer Staples and IT have turned or are turning weak. On the contrary, beaten-down cyclical sectors are still "lagging" but starting to improve, with Financials moving to "improving" zone first.
- **Sectors to play on this potential sector rotation**: 1) **Buy beaten-down "reopening" sectors selectively**, including HK/China apparels, wine & beer, restaurants, online travel agencies, shopping mall landlords; **2) Buy reflationary plays** as inflation expectations are rising along with economic outlook. Banks and Insurers should benefit from moderately higher inflations, bond yields and interest rates. Inflation expectations are also being boosted by Joe Biden's promised fiscal stimuli such as infrastructure spending.
- **Remain positive on Internet giants over medium-to-long term**, despite short-term profit-taking. "Stay-at-home" stocks (mobile games, e-commerce, online education, online clinic, SAAS) will be under pressure if the pandemic has an end in sight. That said, Internet sector will continue to benefit from structural changes post-COVID, and companies have accumulated much more users during the pandemic period.

Daniel So, CFA
(852) 3900 0857
danielso@cmbi.com.hk

Market Data

Hang Seng Index	26,301
52-week High / Low	29,175/21,139
3-month avg. daily t/o	HK$128.1bn

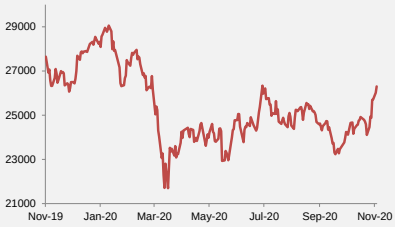
Source: Bloomberg

Indices Performance

	HSI	HSCEI
1-month	9.0%	10.1%
3-month	7.9%	6.0%
6-month	8.5%	7.3%

Source: Bloomberg

12-month HSI Performance



Source: Bloomberg

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Vaccine race takes a big step

■ **90% efficacy rate far exceeded expectations**

On 9 Nov, Pfizer and BioNTech, two pharmaceutical firms, announced that their vaccine candidate is more than 90% effective in preventing symptomatic cases of COVID-19. Pfizer says that no serious safety concerns have arisen in the trials under way, although further efficacy data are being collected.

U.S. top infectious disease specialist Dr. Anthony Fauci said in Aug that scientists hoped a vaccine to prevent the coronavirus would be at least 75% effective, but 50%-60% efficacy also would be acceptable.

Some important questions about the vaccine remain, such as how well it works in elderly people, the group most vulnerable to COVID-19, and its long-term efficacy. Besides, there are still a lot of work to be done, such as regulatory approvals, mass manufacturing, large-scale distribution. Nonetheless, this news is hugely encouraging.

■ **Potentially more good news from other vaccines**

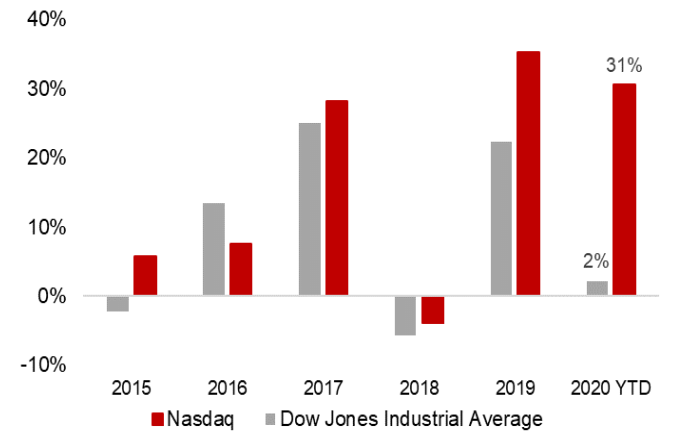
News about two more vaccines, from AstraZeneca, another big pharma company, with a team at Oxford University, and Moderna, an American biotechnology company, is also expected in the coming weeks.

Huge boost for cyclical stocks

■ **Positive for broad market, more so for Cyclicals**

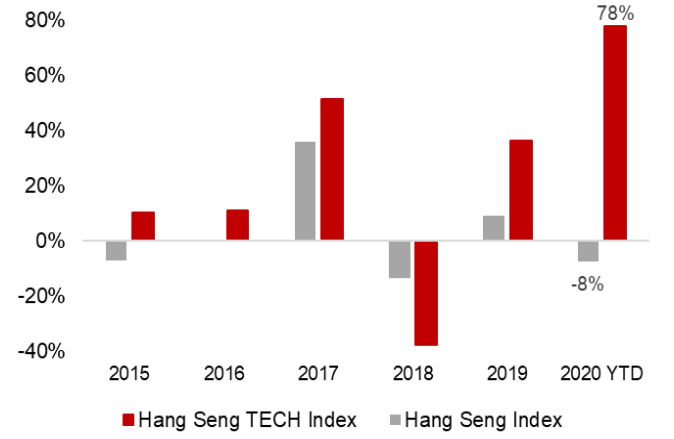
While news of good progress in vaccine development is positive for global economic outlook and the stock market in general, we **expect cyclical stocks (many of them are old-economy stocks) which are most sensitive to economic cycles and sectors which were hardest hit by the pandemic to enjoy the biggest rally** going forward.

Figure 1: Annual returns of Nasdaq & Dow Jones



Source: Bloomberg, CMBIS

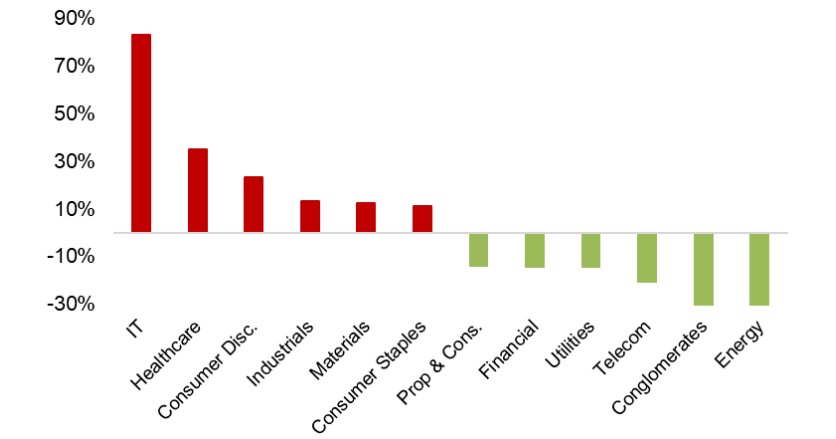
Figure 2: Annual returns of HSI & Hang Seng TECH



Source: Bloomberg, CMBIS

New-economy stocks, on the other hand, have already significantly outperformed since the outbreak (Fig. 1, 2 & 3).

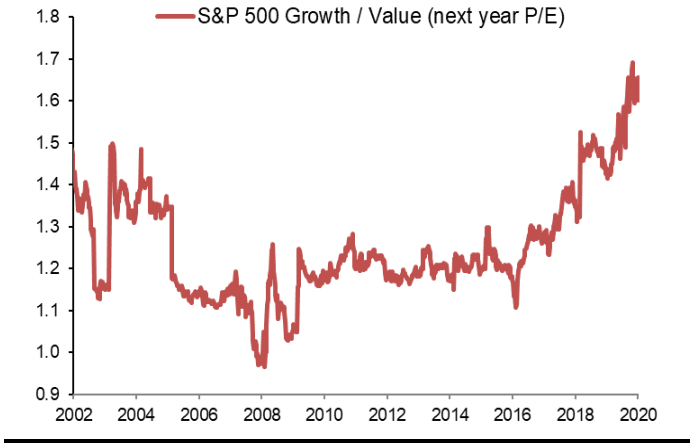
Figure 3：YTD returns of Hang Seng Composite Industry Indexes



Source: Bloomberg, CMBIS, as of 9 Nov 2020

While new-economy stocks' outperformance has been partly supported by better earnings during this great recession, their valuation premium in terms of P/E multiples over old-economy stocks has also risen to the widest in at least two decades (Fig. 4).

Figure 4：Valuation gap of S&P 500 Growth & Value



Source: Bloomberg, CMBIS

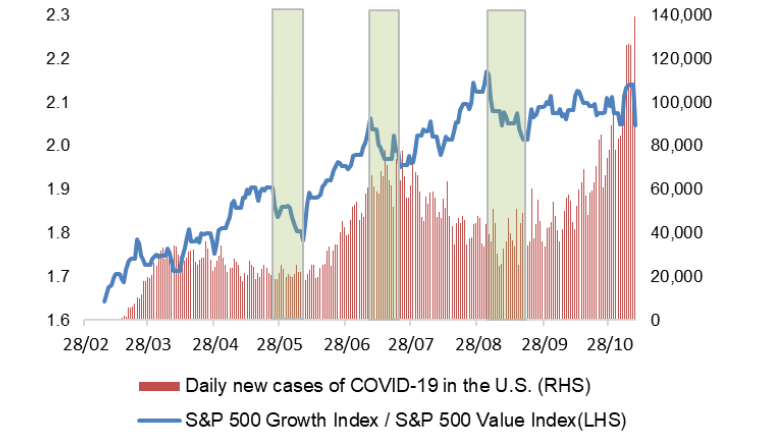
Sector rotation could last for longer this time

Although growth stocks have significantly outperformed value stocks YTD, there were several sector rotations when value outperformed. But each one did not last long: two weeks in May, two weeks in Jul, and three weeks in Sep (Fig. 5).

The reasons were twofold: 1) rotations occurred only because growth stocks were overbought, but fundamentals did not warrant a sustainable rotation into value; 2) resurgence in COVID-19 cases, particularly in the U.S., put a premature end to the rotations in May and Sep.

This time can be different, i.e. the rotation into value/cyclical stocks may be more long-lasting, thanks to the great progress in vaccine development and therefore better outlook in recovery of the economy and corporate earnings.

Figure 5: Sector rotations were short-lived since pandemic



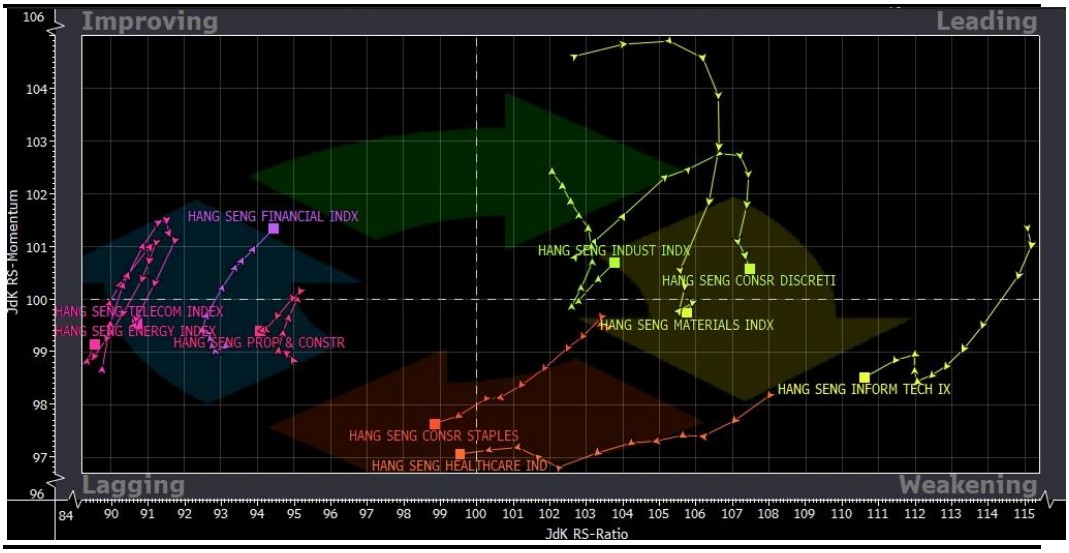
Source: Bloomberg, CMBIS

■ Growth stocks turning weak, Value stocks improving

In HK market, Relative Rotational Graph (RRG) (Fig. 6) of the Hang Seng Composite Index shows that some growth sectors have turned or are turning weak. Healthcare and Consumer Staples have been weakening for weeks, and are now in “lagging” zone. IT, the undisputed leader YTD, is still in “leading” zone but is weakening too.

On the contrary, beaten-down cyclical sectors are still “lagging” but starting to improve, with Financials moving to “improving” zone first.

Figure 6: Weekly Relative Rotational Graph of Hang Seng Composite Index



Source: Bloomberg, CMBIS

Strategy

Vaccine progress induces higher confidence in economic recovery, and thus more room of earnings upgrade and revaluation in cyclical stocks. We suggest the following strategies to play on this potential sector rotation:

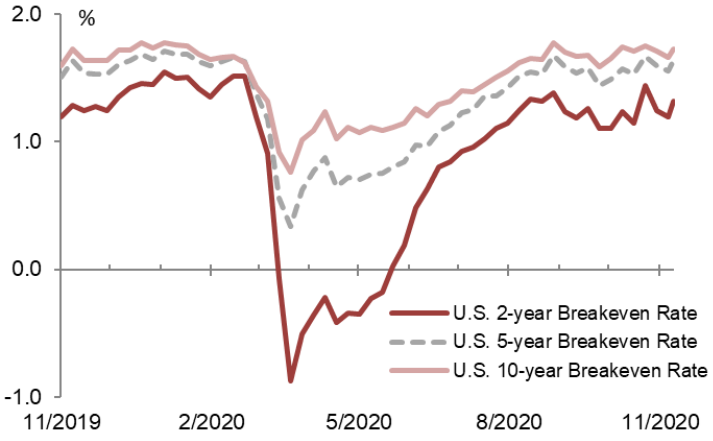
1) **Buy beaten-down "reopening" sectors selectively, including HK/China apparels, wine & beer, restaurants, online travel agencies, shopping mall landlords**. Be aware that certain stocks such as Mainland restaurants have outperformed and already priced in strong recovery. Airlines and hotels would benefit too, but as they rely more on cross-border travels, and governments would probably be prudent in opening borders, their earnings recovery are less certain. Key names include **Anta Sports (2020 HK, BUY)**, **CR Beer (291 HK, BUY), Moutai (600519 CH, BUY)**, **Cafe de Coral (341 HK, BUY)**, **Tongcheng-Elong (780 HK, BUY)**.

2) **Buy reflationary plays**. Inflation expectations are rising as economic outlook improves (Fig. 7). **Banks and Insurers** should benefit from moderately higher inflations, bond yields and interest rates. They typically outperformed when inflation expectations rise (Fig. 8 & 9). Inflation expectations are also being boosted by Joe Biden's promised fiscal stimuli such as infrastructure spending*. Key names include **Ping An Bank (000001 CH, BUY**) and **China Life (2628 HK, BUY)**.

3) **Remain positive on Internet giants over medium-to-long term**, despite short-term profit-taking. "Stay-at-home" stocks (mobile games, e-commerce, online education, online clinic, SAAS) which to a certain extent benefit from COVID-19 will be under pressure if the pandemic has an end in sight. That said, Internet sector will continue to benefit from structural changes post-COVID, e.g. consumers have become more attached to online spending and such behaviour won't be easily reversed, and companies have accumulated much more users during the pandemic period.

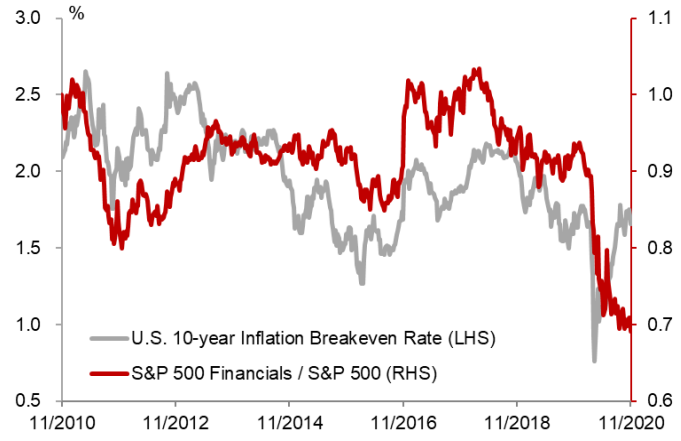
* Note: Biden has won the U.S. Presidential Election, according to numerous U.S. media, while Donald Trump has not conceded and is contesting the results.

Figure 7: U.S. inflation expectations are rising



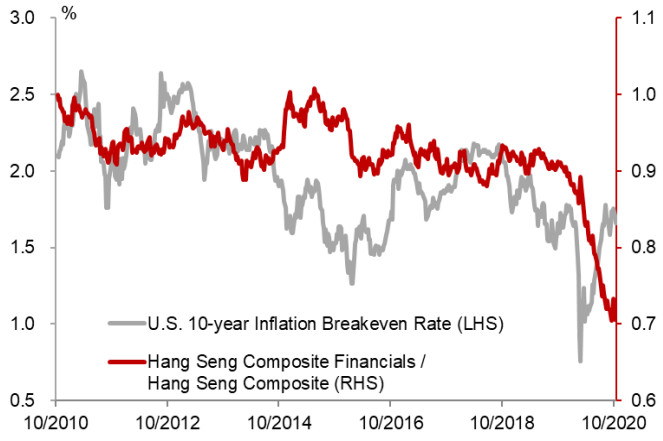
Source: Bloomberg, CMBIS

Figure 8：U.S. financials stocks tended to outperform when inflation expectations rise



Source: Bloomberg, CMBIS

Figure 9：HK financials stocks tended to outperform when inflation expectations rise



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CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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