September 14, 2015

Global Stock Market Multiple Expansion Comparison

Last week (September 7th to 11th), China A share market was flat at -0.6% and H share market rose 4.3% led by Autos.

In August, FX reserves fell US$94bn to US$3.56 trillion. That plus $60 billion trade surplus, and an impact of unknown magnitude from changes in accounting rules equates to ~$155 billion of capital outflow from August 10th to 31st, or ~200 billion of capital flight for the full month of August pro forma.

We do not think that the PBOC and the RMB will respond dramatically if the Fed raises rates on September 17th. It might, at most, weaken the fix by a couple of percentage points if the dollar strengthens a lot.

We See Further Downside in the A Share Market

The following two charts summarize the comparisons of 1 and 3-years stock market performances and their drivers (earnings growth vs multiple expansions) among the major stock markets globally. In both 1 and 3 years timeframe, SHCOMP and CSI 300 performances top the comparables, with 2/3 of the index appreciation coming from multiple expansions.

Our conclusion is that although the Chinese A share market has seen a correction recently, it still appears to be very expensive in a global context. The multiples, reflecting mostly market appear to be too high; in addition we consider the current estimates of forward looking earnings to have major downward risks.

Table 1: Global comparison of 1-year stock market performance (%), broken down by earnings growth and multiple expansion

1 Year	CSI300	SHCOMP	NKY	SPX	INDU	HS Index	FTSE
Index Appreciation	32.66%	32.58%	2.61%	-2.17%	-4.33%	-12.72%	-13.98%
Earnings Growth	11.83%	11.15%	9.43%	7.85%	8.07%	7.85%	1.63%
Multiple Expansion	20.83%	21.43%	-6.82%	-10.03%	-12.40%	-20.57%	-15.61%

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Chart 1: Global comparison of 1-year stock market performance (%), broken down by earnings growth and multiple expansion

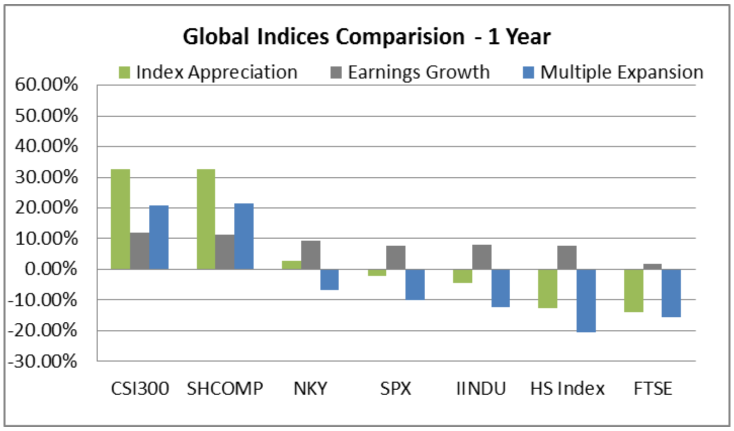
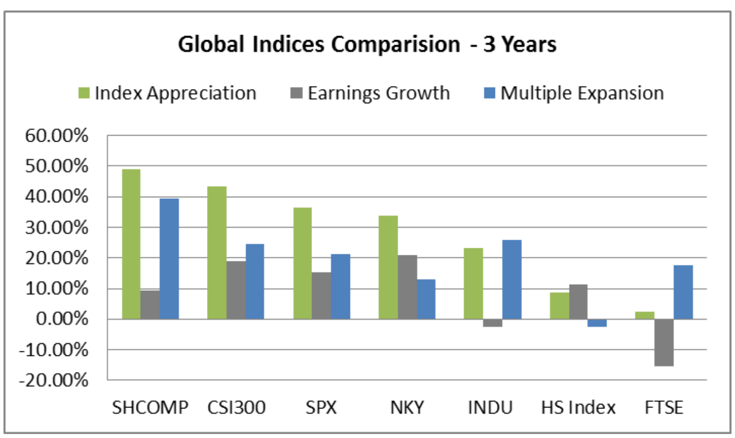


Table 2: Global comparison of 3-year stock market performance (%), broken down by earnings growth and multiple expansion

3 Years	SHCOMP	CSI300	SPX	NKY	INDU	HS Index	FTSE
Index Appreciation	48.89%	43.44%	36.32%	33.89%	23.21%	8.83%	2.48%
Earnings Growth	9.44%	19.00%	15.22%	21.04%	-2.52%	11.25%	-15.29%
Multiple Expansion	39.45%	24.44%	21.10%	12.85%	25.72%	-2.42%	17.77%

Chart 2: Global comparison of 3-year stock market performance (%), broken down by earnings growth and multiple expansion



Although the relaxed liquidity conditions as a result of central banks' expansionary monetary and credit policies have played a large role in all major capital markets, the response of the

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domestic and external markets to such expansionary national monetary policies differ - to a large extent because of the unequal status of the national currencies involved, and because of differing national exchange rate regimes.

QE in the US spreads globally; in Japan it resides domestically and in China it leaks out via the capital account.

Both the US dollar and the Yen have market-determined exchange rates. Liquidity created in Yen largely stays in the domestic markets for yen-denominated instruments. For the US dollar, as the only serious global reserve currency, the domain over which additional US$ liquidity injected by the Fed is spread is global, rather than local. The dollar liquidity does not vanish unless it is accumulated by foreign central banks as idle foreign exchange reserves, which, in the aggregate, is no longer the case. In fact, foreign central banks are reducing their foreign exchange reserves as they try to prevent excessive weakening of their currencies.

The RMB has long been effectively a tightly managed exchange rate, pegged to the US dollar. Following a brief flirtation with a greater degree of market determination of the daily RMB fix, the RMB is once again managed tightly as a currency pegged to the dollar. Additional liquidity injected by the PBOC (domestic credit expansion) leaks out through the capital account. This shows up as reserve losses. The total increase in money supply equates to domestic credit expansion minus international reserve losses. So liquidity injections of RMB do less for liquidity in the domestic RMB markets.

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