

# Market Strategy

**April 2010**

## MARKET OUTLOOK

### *Continued to overweight Chinese banks*

Encouraging jobs report for March indicates the U.S. economy continues to improve and interest rate hike will be earlier than expected. China is also on track for recovery this year, aiming to achieve GDP growth of 8% and contain inflation at or below 3%. In the first two months of 2010, China's exports and imports grew 31.4% and 63.6% yoy respectively. The Purchasing Managers' Index rose to 55.1% in March from 52.0% in the previous month showing a continuous expansion in manufacturing sector. Growth in retail sales value accelerated from 15.5% yoy in 2009 to 17.9% yoy in the first two months of 2010 reflecting effective government policy to drive domestic consumption. In order to manage inflation expectations, we believe China will further raise reserve requirement ratio for commercial banks in April but keep interest rate unchanged in the second quarter. In the second half of the year, China is likely to allow a gradual revaluation of the renminbi. With the projected EPS growth of 20%-plus and 2010 PER of 10-11x, valuation of Chinese banks remains attractive in our view. We stick to our BUY rating on ICBC (1398) and CCB (939). Considering a strong government intervention in the housing market in near term, we have downgraded Chinese property developers from overweight to neutral. State-owned enterprises such as China Overseas Land (688), China Resources Land (1109) and Poly HK Investments (119) will deserve premium valuation to peers.

### *Cut year-end target for the HSI to 25,000*

The Hang Seng Index is currently sitting above the 20-day and 50-day moving averages that should be viewed as technically positive although the market turnover is relatively thin. According to our estimates, the benchmark index is presently trading at a prospective PER of 14.5x with EPS growth of 15% in 2010. Current valuation is 5-10% below historical average. Taking into account the PRC government's conservative GDP growth target for 2010, we have cut our year-end forecast for the Hang Seng Index from 27,000 to 25,000 based on 17.0x 2010 earnings. Again, the HSCEI is expected to outperform the Hang Seng Index given a sluggish performance in heavily weighted HSBC (5) and China Mobile (941). We also maintain our overweight position on Hong Kong property stocks, especially Cheung Kong (1) and SHK Properties (16).

### *Short-term investors should bet on laggards*

Stock markets in the Greater China region lagged behind global markets in the first quarter. Speculation on renminbi revaluation is likely to bring an influx of funds into Hong Kong and China stock markets in the second quarter. We expect Hang Seng Index to reach 23,000 this month. Short-term investors should bet on laggards such as HSBC (5), Henderson Land (12), China Shenhua (1088), China Shipping Development (1138) and Zijin Mining (2899).

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## MARKET REVIEW

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### *Global equities rallied on gradual stabilization in U.S labor market*

A sign of stabilization in the U.S. labor market (unchanged jobless rate for February and March), together with the EU agreement on bailout plan for Greece and Japan's additional monetary easing measures helped to boost global equity markets in March. Dow, Nasdaq, FTSE 100 and CAC 40 surged 5.1%-7.2% whilst DAX and Nikkei 225 jumped 9.5%-9.9%. Stock markets in Singapore, Malaysia, Thailand, Korea, Taiwan and Indonesia soared 3.9%-9.2%. Hang Seng Index and HSCEI advanced 3.1% and 7.4% respectively, basically in line with other Asian markets. However, China's Shanghai SE Composite Index merely increased 1.9% as investors concerned that China would further tighten monetary policy. In fact, Australia, Malaysia and India have further raised key interest rates in March while the yield on 10-year U.S. treasury notes climbed from 3.61% to 3.84%. Despite the strength of the U.S. dollar, crude oil futures price rose 5% in March to settle at around US\$84 a barrel driven by an improving outlook for the global economy.

### *China banking and insurance stocks led the rally*

Among the constituents of HSCEI, banking, insurance, auto, airline and cement stocks outperformed. Chinese banks' earnings for 2009 were largely in line with market expectations and the impact on proposed fund raising plans had been fully digested. ICBC (1398), CCB (939), BOC (3988) and BoComm (3328) gained 8%-10% whilst CMB (3968) and CITIC Bank (998) added 12%-17%. Three largest insurers closed up 8%-13%. Robust car sales stimulated buying interest on auto companies. BYD Company (1211) and Dongfeng Motor (489) jumped 29% and 12% respectively. Recovery of passenger traffic more than offset the adverse effect of rising oil price. Air China (753) and Cathay Pacific (293) rose 13%-18%. Expectation of stronger cement demand in the second quarter sent cement counters higher. Anhui Conch (914) and CNBM (3323) increased 12%-13%. On the other hand, oil, coal, shipping/port, railway sectors underperformed the HSCEI. PetroChina (857), CNOOC (883) and Sinopec (386) went up 4%-5% given weaker-than-expected earnings for PetroChina. China Shenhua (1088) and China Coal (1898) lost 0%-2% perhaps due to worries about introduction of resource tax. China Shipping Development (1138) and Cosco Pacific (1199) declined 3%-4% on profit taking. China Railway Group (390) and China Railway Construction (1186) plunged 4%-6%. Performance of power and non-ferrous metal stocks were mixed.

### *China property stocks moved in line with the HSCEI amid negative news*

China's property market experienced a deep contraction in transaction volume in February but rebounded sharply in March. Contracted property sales revenue attained by leading property developers such as Guangzhou R&F (2777), Shimao Property (813) and Greentown China (3900) grew 21%, 21% and 199% yoy respectively in the first quarter of 2010 whilst average residential prices remained stable at high levels. Skyrocketing land prices in Shanghai and Beijing eventually prompted government intervention. The Ministry of Land and Resources announced suspension of land sales until mid-April pending the local governments submitted land supply plans for overall commodity housing and social welfare housing. The SASAC ordered 78 centrally administered SOEs to withdraw from the real estate market. Sino-Ocean Land (3377), a victim of the new policy, faced a heavy sell-off with share price down 0.3% in March. Despite the negative news, ten largest China property stocks (except for Sino-Ocean Land) advanced 1%-11% with an average gain of 6.5% amid speculation on renminbi appreciation.

### *Continued re-rating of Hong Kong property stocks*

Fall in share prices of heavily weighted HSBC (5), Hang Seng Bank (11) and China Mobile (941) depressed performance of Hang Seng Index. HSBC (5) tumbled 8% on lower-than-expected earnings. Hang Seng Bank (11) shrank 5% on dividend cut. China Mobile (941) retreated 2%, as the minority shareholders did not welcome the proposed investment in Shanghai Pudong Development Bank. A positive re-rating of Hong Kong property stocks continued given sound fundamentals, rising residential prices in the secondary market and stronger-than-expected earnings. SHK Properties (16), Wharf (4), Swire Pacific (19) surged 8%-9%. MTR Corp (66) and HK & China Gas (3) added 9%-11% on tariff increases. Esprit (330) rose 11% although the former chairman further disposed shares in the open market.

### Stock Performance Summary for March 2010

Sector	Stocks	% chg in share price in Mar 10	Reasons
	Hang Seng Index (21,239)	+3.1	Rally in US/Europe stock markets
	HSCEI (12,397)	+7.4	
<b>Outperform</b>			
HK Property	Cheung Kong (1), SHK Properties (16), Henderson Land (12), Swire Pacific (19), New World Development (17), Sino Land (83), Hang Lung Properties (101), Wharf (4)	+3 to +9	Rising residential price in both primary and secondary markets
Insurance	China Life (2628), Ping An Insurance (2318) PICC P&C (2328)	+8 to +13	
China Banking	ICBC (1398), CCB (939), BoComm (3328), BOC (3988), CMB (3968), CITIC Bank (998)	+8 to +17	Fund raising pressure fully digested
Cement	Anhui Conch (914), CNBM (3323)	+12 to +13	
Airline	Cathay Pacific (293), Air China (753)	+13 to +18	Recovery in passenger traffic
Auto	Dongfeng Motor (489), BYD Company (1211)	+12 to +29	Strong car sales
Misc	Esprit (330), HK & China Gas (3), MTR (66)	+9 to +11	
<b>In line/ Mixed</b>			
China Property	China Overseas Land (688), Shimao (813) China Resources Land (1109), Longfor (960) Country Garden (2007), Agile Property (3383), Poly HK (119), Guangzhou R&F (2777)	+4 to +11	Recovery of property sales in March without a meaningful decline in property prices
Telecom	China Mobile (941), China Unicom (762)	-2 to -6	
	China Telecom (728)	+12	
Coal	China Coal (1898), China Shenhua (1088)	-2 to -0	High exposure of Yanzhou Coal to spot coal price
	Yanzhou Coal (1171)	+14	
Power	Datang Power (991), Huaneng Power (902)	-0 to -3	
	China Resources Power (836)	+8	
Non-ferrous metal	Jiangxi Copper (358), Chalco (2600)	+7 to +11	
	Zijin Mining (2899), MCC (1618)	-4 to -8	
<b>Underperform</b>			
Oil	PetroChina (857), Sinopec (386), CNOOC (883)	+4 to +5	Higher crude oil price
Shipping/Port	China Cosco (1919), China Merchants (144)	+2 to +6	Decline in BDI index
	China Shipping Dev (1138), Cosco Pacific (1199)	-3 to -4	
HK Banking	BOC Hong Kong (2388), Bank of East Asia (23)	+1 to +6	Earnings of HSBC below market expectation
	HSBC (5), Hang Seng Bank (11)	-5 to -8	
Railway	China Railway Group (390), China Railway Construction (1186)	-4 to -6	Railway stocks out of favour
Misc	Tencent (700), Foxconn (2038), Hutchison (13)	+2 to +3	



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