

Market Strategy

August 2010

MARKET OUTLOOK

US may adopt quantitative easing policy

The U.S. Federal Reserve may adopt quantitative easing policy in the near future given a slowdown of the U.S. economy and increasing political pressure from midterm election. It means no chance of rate hike over the next six months. This will definitely put pressure on the U.S. dollar against major international currencies and boost commodity prices. Strong rebound in the euro and successful sale of government bonds in Greece and Spain during July have eased market concerns over European sovereign debt issue. Though the global economic outlook remains uncertain for the second half of the year, abundant liquidity will give support to global asset prices in the third quarter.

Shanghai SE Composite Index has bottomed out

The Chinese economy is also slowing evidenced by a further decline in July purchasing managers' index. However, we do not think the government will change the annual target for new renminbi loan or relax the property measures until housing prices are back to acceptable levels. Having said that, further tightening in macroeconomic policies is absolutely unlikely paving the way for a continuous rebound in the A-share stock market. It has been rumoured that China Insurance Regulatory Commission will allow insurance companies to expand the proportion of their equity investments from 15% to 25% which is expected to add some RMB 400bn funds to the stock market. We do believe the Shanghai SE Composite Index has bottomed out in July.

Expect the Hang Seng Index to reach 22,000-22,500 within two months

Outlook for the Hong Kong stock market looks promising in coming two months given an upturn in A-share stock market, weakening U.S. dollar and satisfactory corporate earnings. We believe the Hang Seng Index will reach 22,500-23,000 within two months. Any pull back should be treated as a buying opportunity. Hong Kong banking and property counters should continue to outperform. Our top picks are BOC Hong Kong (2388) and SHK Properties (16). For H shares, we believe cyclical stocks including banking, cement, coal, shipping, steel and non-ferrous metal stocks will outperform the HSCEI. China Life Insurance (2628), which is a laggard in July, is attractive to short term investors in our view. On the other hand, we remain cautious on Chinese property developers.

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MARKET REVIEW

Global stock markets rallied on weakening U.S. dollar

Global equity markets rallied in July on strong quarterly earnings from major U.S. companies and easing concerns about sovereign debt in Europe after successful sale of government bonds in Greece and Spain. Dow, Nasdaq and FTSE 100 surged 6.9%-7.1%. Nikkei 225 rose 1.6%. Most stock markets in Asia advanced 4% to 7%. Shanghai SE Composite Index soared 10.0% as investors anticipated the relaxation of austerity measures in China. Solid economic growth for countries in Asia urged Korea, India and Thailand to raise their key interest rates last month. Weakening U.S. dollar against major international currencies and falling gold price, to some extent, reflected a rebound in risk appetite. The euro, British pound and Japanese yen appreciated 6.5%, 4.9% and 2.5% respectively versus the U.S. dollar whilst the renminbi was steady.

Hong Kong's development as an offshore renminbi center caused re-rating of local banks

Hang Seng Index closed up 4.5% in July led by local banks and property developers. The signing of a revised settlement agreement between PBOC and HKMA on the clearing of renminbi business in Hong Kong and proposed privatization of ICBC Asia (349) triggered a positive re-rating of local banks. BOC Hong Kong (2388), HSBC (5) and Bank of East Asia (23) soared 12%, 10% and 8% respectively. Better than expected land auction results and encouraging pre-sale of The Larvotto gave a boost to property stocks. SHK Properties (16), Hang Lung Properties (101), New World Development (17), Wharf (4) and Swire Pacific (19) advanced 6% to 11%. Esprit (330) rose 15% following a strong run in the euro. Tencent (700) saw a technical rebound of 15% after a dip of 13% in the previous month. Port operators including China Merchants (144) and Cosco Pacific (1199) also gained 13%-14%.

Insurance, telecom and oil sectors lagged behind other China stocks

Cyclical stocks including cement, coal, shipping, steel, non-ferrous metal and property companies substantially outperformed the HSCEI which climbed 3.8% in July. The rise in A-share stock market was an important catalyst. Angang Steel (347), the best performing constituent of the HSCEI, jumped 25%. Anhui Conch (914) and CNBM (3323) added 17%-19% on cheap valuation. China Shipping Development (1138) rose 15% amid the rebound in Baltic Dry Index. Jiangxi Copper (358) and Chalco (2600) went up 14%-17% due to a surge in copper and aluminum prices in the international market. However, a significant environmental incident sent Zijin Mining (2899) lower by 15% making it the worst performing constituent of the HSCEI. Ten largest PRC property developers, except for Sino Ocean Land (3377), increased by an average of 18% betting on relaxation of property measures. Large Chinese banks moved in line with the benchmark index while the newly listed ABC (1288) closed up 9% against the IPO price. On the other hand, insurance, telecom and oil stocks underperformed the HSCEI. Share prices of China Unicom (762), Sinopec (386), CNOOC (883) and China Life (2628) dropped 1-2%. Ping An Insurance (2318) suspended trading for the whole month of July.

Stock Performance Summary for July 2010

Sector	Stocks	% chg in share price in Jul 10	Reasons
	Hang Seng Index (21,029)	+4.5	Strong rebound in global stock markets
	HSCEI (11,905)	+3.8	
Outperform			
Steel	Angang Steel (347)	+25	
Cement	Anhui Conch (914), CNBM (3323)	+17 to +19	Notice on accelerating cement industry consolidation
Non-ferrous metal	Jiangxi Copper (358), Chalco (2600)	+14 to +17	Rising copper and aluminum prices in international market
Port operator	China Merchants (144), Cosco Pacific (1199)	+13 to +14	Robust China's export in Jun
Railway	China Railway Group (390), China Railway Construction (1186)	+10 to +15	
Miscellaneous	Esprit (330), Tencent (700), Air China (753), CITIC Pacific (267)	+10 to +15	Rising euro benefits Esprit
China property	Ten largest PRC property developers except for Sino-Ocean Land (3377)	+8 to +25	Speculation on relaxation of tightening measures
Shipping	China Cosco (1919), China Shipping Dev (1138)	+8 to +15	Rebound in Baltic Dry Index
Coal	China Coal (1898), Yanzhou Coal (1171)	+9 to +10	
China bank	CMB (3968), Minsheng Bank (1988), ABC (1288)	+6 to +12	Better than expected share price performance of Agricultural Bank of China
	ICBC (1398), CCB (939), BOC (3988), BoComm (3328), CITIC Bank (998)	+3 to +5	
HK bank	HSBC (5), BOC HK (2388), BoEA (23)	+8 to +12	Enlarged scope of Renminbi business in Hong Kong
HK property	Cheung Kong (1), SHK Properties (16), Hang Lung Properties (101), Swire Pacific (19), New World Development (17), Sino Land (83), Henderson Land (12), Wharf (4)	+4 to +11	Positive land auction results and active residential sales in both primary and secondary markets
In line/ Mixed			
Power	China Longyuan (916), Datang Power (991)	+5 to +13	
	Huaneng (902), China Resources Power (836)	-3 to -5	
Automobile	Dongfeng Motor (489)	+18	
	BYD Company (1211)	-8	
Underperform			
Telecom	China Mobile (941), China Unicom (762), China Telecom (728)	-1 to +3	Profit taking after a strong run in June
Oil	CNOOC (883), PetroChina (857), Sinopec (386)	-2 to +1	Steady crude oil price
Insurance	China Life (2628), Ping An Insurance (2318), China Pacific Insurance (2601)	0 to -1	Ping An suspending trading for the whole month
Miscellaneous	Zijin Mining (2899)	-15	Growing concerns of corporate governance after the environmental incident



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