

Market Strategy

December 2009

MARKET OUTLOOK

Continuous inflow of capital as a key driver

We are optimistic about Hong Kong's stock market over the next twelve months. Firstly, China's top leaders agreed at the Political Bureau meeting that China would continue to implement proactive fiscal policy and moderately easy monetary policy next year. The statement should help strengthen market confidence and reduce the risk of a dramatic change in China's macroeconomic policies in the near term. Secondly, the recent breakout in gold price, triggered by India's purchase of 200 metric tons of gold from IMF, clearly indicates that investors have lost confidence in the U.S. dollar. The downward adjustment for U.S. 3Q GDP growth from 3.5% to 2.8% suggests that the Federal Reserve may have to keep low interest rates longer than expected. We believe the weakness in U.S. dollar will continue which is always positive to Hong Kong stock market if the history repeats. Thirdly, Dubai World's debt default in our view could eventually benefit China/Hong Kong stock markets because it may accelerate capital flowing into Asia from Middle East. The aggregate balance of the Hong Kong's banking system increased by 73% from \$184 billion at end-September to \$318 billion at end-November, reflecting a continuous inflow of capital.

Attractive valuation on the back of strong earnings growth

According to market consensus, the EPS growth for the Hang Seng Index is estimated at 20-25% next year implying that the index is currently trading at 2009 PER of 17.5x and 2010 PER of 14.0-14.5x compared with historical average PER of 15.9x and 14.5x in the past 10 and 30 years respectively. Given a continuous influx of funds, we have adjusted upward our 2010 year-end target for the Hang Seng Index from 25,600 to 27,000 based on 18x 2010 earnings.

Overweight China banks, oil & gold and consumer stocks

We recommend that investors should overweight China banks, oil & gold and consumption related stocks in 2010. China banks and upstream oil companies are expected to attain EPS growth of more than 20% next year driven by robust loan growth and higher oil price respectively. We also believe spot gold price can reach US\$1,300 an ounce before mid-2010 on strong demand from central banks around the world and weakening U.S. dollar. For consumer stocks, we prefer auto, food & beverage and pharmaceutical sectors. Our top picks include ICBC (1398), CCB (939), PetroChina (857), Zijin Mining (2899), Zhaojin Mining (1818), Dongfeng Motor (489), Mengniu Dairy (2319) and Sinopharm (1099).

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MARKET REVIEW

Weakening US dollar sent equity and commodity prices higher in November

Major stock markets in U.S., Europe and Asia ex-Japan rallied in November given a continued improvement in global economy and weakening U.S. dollar. Dow Jones Industrial Average, Nasdaq and FTSE 100 surged 6.5%, 4.9% and 2.9% respectively. Shanghai SE Composite Index advanced 6.7%. Hang Seng Index closed up 0.3% whilst the HSCEI added 1.7%. Nikkei 225 plunged 6.9% as investors worried the appreciation of yen might affect corporate earnings. IMF's disposal of 200 metric tons of gold to India boosted gold price to US\$1,212 an ounce on December 2, up 14% month-on-month. Average crude oil futures price increased by 3.1% from US\$75.8 a barrel in October to US\$78.2 a barrel in November. Meanwhile, euro and yen rose 1.6% and 4.3% respectively versus the U.S. dollar.

Coal, steel and insurance stocks outperformed

Air China (753) and Dongfeng Motor (489) were the best performing constituents of the HSCEI in November. The former was stimulated by a change in China's fuel surcharge regulations effective November 14. The latter was supported by favorable government policies on auto sales. Insurance companies, coal and steel producers also outperformed the HSCEI in November, driven by the upturn in the Shanghai stock market and the increase in coal and steel prices in China. Yanzhou Coal (1171) and China Coal (1898) soared 25% and 18% respectively. China Shenhua (1088), Angang Steel (347) and Maanshan Iron & Steel (323) gained 6%-10%. China Life (2628), Ping An Insurance (2318) and PICC P&C (2328) added 4%-7%. Higher gold price sent share price of Zijin Mining (2899) higher by 6%. China banks showed mixed performance after they were advised by the CSRC to strengthen their balance sheet. ICBC (1398), CMB (3968) and China CITIC Bank (998) climbed 3%-8% whilst BOC (3988) and BoComm (3328) lost 3%-5%.

Weakness in oil stocks looked unreasonable

Telecom and railway stocks, which were defensive in nature, basically moved in line with the benchmark indexes. Oil, power, power equipment, cement as well as HK/China property stocks underperformed. Upstream oil companies such as PetroChina (857) and CNOOC (883) were almost unchanged despite a moderate rise in average crude oil price in November. Oil refineries namely Sinopec (386) and Sinopec Shanghai (338) both declined 4% even though the PRC government raised refined oil products prices by 7% in mid-November. The increase in power tariffs for non-residential users could not offset the adverse effect of rising coal price. Power suppliers including Datang Power (991), Huaneng Power (902) and China Resources Power (836) thus retreated 3%-9%. Cement was the worst performing sector given the concerns of excess industry capacity. Anhui Conch (914) and CNBM (3323) dropped 10%-13%.

Increasing policy risks weighed on China and HK property stocks

Investors continued to take profit on China property developers in response to a flood of Chinese property offerings and uncertainties in land supply policy next year. China Overseas Land (688), Country Garden (2007), China Resources Land (1109) and Guangzhou R&F (2777) tumbled 2%-9%. Leading Hong Kong property stocks fell 2%-7% as the government imposed new property measures to further enhance the transparency of property transactions following a luxury residential apartment changed hand at a record price of \$70,000 per sq.ft.

Stock Performance Summary for November 2009

Sector	Stocks	% chg in share price in Nov 09	Reasons
	Hang Seng Index (21,821)	+0.3	HSI faced strong technical resistance at 23,000
	HSCEI (12,980)	+1.7	
Outperform			
Miscellaneous	Air China (753), Dongfeng Motor (489), Bank of East Asia (23)	+21 to +29	Expectation of continuous favorable policy for auto sales
Coal	China Coal (1898), Yanzhou Coal (1171)	+18 to +25	Expectation of higher coal price in 2010
	China Shenhua (1088)	+6	
Steel	Angang Steel (347), Maanshan Iron & Steel (323)	+6 to +10	Rebound in steel price since mid-October
Insurance	China Life (2628), Ping An Insurance (2318), PICC P&C (2328)	+4 to +7	Rising A-share market
In line/ Mixed			
HK banking	HSBC (5), Hang Seng Bank (11)	+2 to +4	Better than expected 3Q financial results for HSBC
	BOC Hong Kong (2388)	-3	
China Banking	ICBC (1398), CCB (939), CMB (3968), China CITIC Bank (998)	+1 to +8	Promising earnings outlook for China banks
	BOC (3988), BoComm (3328)	-3 to -5	
Non-ferrous metal	Jiangxi Copper (358), Zijin Mining (2899)	+6 to +10	Higher average gold and copper prices in November
	Chalco (2600), CMOC (3993)	-2	
Shipping	China Shipping Development (1138), China Cosco (1919), CSCL (2866)	+0 to +4	Decline in Baltic Dry Index starting mid-November
Telecom, railway, HK Utilities	China Mobile (941), China Unicom (762), China Telecom (728), China Railway Group (390), China Railway Construction (1186), CLP (2), HK Electric (6), HK & China Gas (3)	-2 to +3	Defensive stocks
Underperform			
Oil	CNOOC (883), PetroChina (857), Sinopec (386), Sinopec Shanghai (338)	-0 to -4	Higher average oil price in November
China property	China Overseas Land (688), Shimao (813), Guangzhou R&F (2777), CR Land (1109), Sino-Ocean Land (3377), Shui On Land (272), Country Garden (2007)	-0 to -9	Worries a negative change in government's housing policies and flood of IPOs
HK Property	Cheung Kong (1), SHK Prop (16), Wharf (4), Swire (19), Henderson Land (12), Sino Land (83), Hang Lung Prop (101), New World Dev (17)	-2 to -7	Worries a negative change in government's housing policies
Power	Datang Power (991), Huaneng Power (902), China Resources Power (836)	-3 to -9	Rising tariff cannot offset effect of higher coal price
Power Equipment	Harbin Power (1133), Shanghai Electric (2727)	-2 to -4	
Miscellaneous	China Resources Enterprise (291), MTR (66), Foxconn (2038), Li & Fung (494), BYD (1211), China Merchants (144), Hutchison (13)	-4 to -8	N/A
Cement	Anhui Conch (914), CNBM (3323)	-10 to -13	Excess industry capacity



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