

# Market Strategy

*February 2010*

## MARKET OUTLOOK

*Market downturn will be short-lived*

The pace of recovery in the U.S. economy will be slow given the exceptionally high unemployment rate. We believe Federal Reserve will keep interest rate unchanged for the whole year but developing countries such as China and India may have to raise interest rate to contain inflation. The capital raising plans of China banks will undoubtedly cause earnings dilution and cap share price performance in the near term. However, strong GDP growth in China and appreciation potential of the renminbi will eventually attract inflow of funds into China and Hong Kong. We strongly believe the market downturn will be short-lived. Our year-end target for the Hang Seng Index remains unchanged at 27,000 implying an upside potential of 34%.

*HSI will find a strong support at 19,000*

It is hard to know when the stock market will hit bottom. This may happen anytime within the next two months in our view. Risk-adverse investors should wait for a turnaround signal and then accumulate H-shares especially banking, auto and property stocks. Risk-seeking investors may consider buying stocks when the Hang Seng Index dips below 19,500 as we believe the index should be well supported at 19,000 in terms of fundamental valuation. Based on consensus earnings forecast, the Hang Seng Index at 19,000 will be priced at 2010 PER of 10.5x compared to the historical average of 15.8x over the past ten years.

*Short term trading : overweight Hong Kong properties*

We expect the Hang Seng Index to trade range between 19,000 and 21,000 in February. Port and shipping stocks are likely to underperform due to profit taking. The fundamentals of Hong Kong's economy and property market are improving. We expect mass residential price to rise 10-15% in 2010 and recommend an overweight position on Hong Kong property stocks. Top picks are Cheung Kong (1), SHK Properties (16) and Wharf (4). Valuation of China property stocks has discounted more than 20% fall in contracted sales volume this year and looks attractive to long term investors. Nevertheless, we see no share price catalyst for China property stocks in near term. Perhaps, the announcement of their financial results starting mid-March could be a turning point.

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## MARKET REVIEW

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### *Global equity markets slumped in January*

Worries about credit tightening in China, strengthening U.S. dollar and Obama's plan to limit proprietary trading of banks weighed on equity markets worldwide in the first month of 2010. Although the U.S. and Chinese economies both registered stronger-than-expected GDP growth in the last quarter, investors were unconvinced that the growth momentum could be sustained. Major stock market indexes in the U.S., Europe and Japan tumbled 3.5%-5.9%. Shanghai SE Composite Index declined 8.8%. The Hang Seng Index and the HSCEI plunged 8.0% and 10.1% respectively amid a 30% rise in the average daily market turnover to \$78 billion. Light crude oil futures price dropped 8.2%. Spot gold price slipped 1.5%. The euro and pound sterling fell 3.1% and 0.8% respectively against the U.S. dollar on deepening credit crisis in Greece.

### *Credit tightening and new property measures hurt property stocks*

The People's Bank of China unexpectedly raised commercial banks' reserve requirement ratio in mid-January and set its new loan target at RMB7.5 trillion this year. This implies a slowdown in loan growth from 32% in 2009 to 19% in 2010 but better than 16% in both 2007 and 2008. Meanwhile, BOC (3988) announced its capital raising plan in order to meet the regulator's stricter capital adequacy requirements. The Chinese government also introduced extra administrative measures to curb speculation and investment demand for housing aiming to stabilize the real estate market and prevent the property bubble from bursting. All these moves dampened market sentiment on the stock market especially property stocks. Media reported that property sales transactions in major cities of China decreased more than 50% in January from the previous month. Thus, ten largest China property developers shrank 12%-23% last month whilst share prices of Hong Kong property stocks shed 8%-20%.

### *Commodity stocks underperformed the HSCEI*

Strong US dollar put pressure on commodity stocks. Coal, cement and steel counters underperformed the HSCEI and declined by 10%-21%. CNOOC (883) and Sinopec (386) retreated 10%-12% on falling crude oil price. Two largest insurers and five largest China banks lost 10%-12%. PICC P&C (2328) surprisingly gained 1%. Performance of non-ferrous metal, telecom and HK utilities were mixed. Zijin Mining (2899) and Jiangxi Copper (358) fell 14-15% but Chalco (2600) and CMOC (3993) closed down 3%-8%. China Mobile (941), China Telecom (728), CLP Holdings (2) and HK Electric (6) advanced 0%-3% whilst China Unicom (762) and HK & China Gas (3) cut 13%-14%. Hong Kong banks, except for Bank of East Asia (23), outperformed the Hang Seng Index.

### *Recovery in China's export boosted port and shipping companies*

Port and shipping stocks rallied in January, fuelled by a strong rebound in China's export in December. Cosco Pacific (1199) surged 14%, China Shipping Development (1138), CSCL (2866) and China Merchants (144) added 3%-5%. Li & Fung (494) soared 10% after it signed a sourcing agreement with Wal-Mart Stores. Air China (753) rose 7% along with the recovery in passenger traffic. Share prices of power companies were virtually unchanged as they were priced at bottom valuations. Share prices of power equipment and railway stocks ended lower but managed to outperform the benchmark index.

## Stock Performance Summary for January 2010

Sector	Stocks	% chg in share price in Jan 10	Reasons
	Hang Seng Index (20,122)	-8.0	Credit tightening in China
	HSCEI (11,498)	-10.1	
<b>Outperform</b>			
Miscellaneous	Cosco Pacific (1199), Li & Fung (494)	+10 to +14	
	Air China (753), Esprit (330)	+6 to +7	
Port/Shipping	China Merchants (144), CSCL (2866), China Shipping Development (1138)	+3 to +5	Strong rebound in China's export in Dec 2009
Power	Datang Power (991), Huaneng Power (902), China Resources Power (836)	-0 to -2	Bottom valuation
Power Equipment	Harbin Power (1133), Shanghai Electric (2727)	-5 to -10	Defensive stocks
Railway	CCCC (1800), China Railway Group (390), China Railway Construction (1186)	-1 to -7	Defensive stocks
<b>In line/ Mixed</b>			
Insurance	China Life (2628), Ping An Insurance (2318)	-10 to -11	Falling A-share market
	PICC P&C (2328)	+1	
China Banking	ICBC (1398), CCB (939), BOC (3988), CMB (3968), BoComm (3328)	-10 to -12	Concerns of capital raising
Oil	CNOOC (883), Sinopec (386)	-10 to -12	Decline in crude oil price
	PetroChina (857)	-6	
HK banking	HSBC (5), Hang Seng Bank (11), BOC HK (2388)	-5 to -7	Share placement depressed market interest in Bank of East Asia
	Bank of East Asia (23)	-13	
Telecom/ HK Utilities	CLP Holdings (2), HK Electric (6)	+0 to +3	Defensive stocks
	China Mobile (941), China Telecom (728)		
	China Unicom (762), HK & China Gas (3)	-13 to -14	
Non-ferrous metal	Chalco (2600), CMOG (3993)	-3 to -8	Strong US dollar weighed on commodity prices
	Jiangxi Copper (358), Zijin Mining (2899)	-14 to -15	
<b>Underperform</b>			
HK property	Cheung Kong (1), Swire Pacific (19)	-8 to -10	Worries about tightening credit in China
	SHK Properties (16), Henderson Land (12), Hang Lung Properties (101), Sino Land (83), New World Development (17), Wharf (4)	-13 to -20	
China property	China Overseas Land (688), Evergrande (3333), China Resources Land (1109), Shimao (813), Country Garden (2007), Glorious Property (845), Sino-Ocean Land (3377), Agile Property (3383), Longfor (960), Poly HK (119), R&F (2777)	-12 to -23	Drastic government measures to curb property demand
Coal	China Shenhua (1088), China Coal (1898), Yanzhou Coal (1171)	-10 to -16	
Auto	Dongfeng Motor (489), BYD Company (1211)	-9 to -17	
Cement	Anhui Conch (914), CNBM (3323)	-14 to -19	
Steel	Angang Steel (347), Maanshan Iron & Steel (323)	-17 to -21	
Miscellaneous	CITIC Bank (998), CITIC Pacific (267)	-21	



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