

# Market Strategy

*July 2010*

## MARKET OUTLOOK

### *Increasing risk of double-dip recession*

The global economy is facing the risk of double dip recession since the manufacturing activities in the U.S., China and eurozone all slowed for the second straight month in June. Europe's sovereign debt crisis remains unsolved although most developed countries have committed to halving budget deficits by 2013 through spending cuts and tax increases. Deep correction in major stock markets over the past two months and fall in the 10-year U.S. treasury yield below 3% for the first time since April 2009 showing that the financial market is dominated by risk adverse investors.

### *Range trading is expected but the risk is on the downside*

The outlook for the Chinese economy is also uncertain. Revaluation of Renminbi shortly after the recent G20 meeting, nationwide increase in minimum wages and removal of export tax rebates on 406 commodities effective this month are expected to affect China's export in second half of the year. Moreover, China is unlikely to relax its tightening measures on property market in near term given no meaningful adjustment in housing prices year-to-date. Therefore, China's GDP growth will be substantially lower in the third quarter leading to downgrades in corporate earnings. We believe the Hang Seng Index will continue to move between 19,000 and 21,000 in July but the risk is on the downside. In worst-case scenario, the benchmark index may reach 18,000 within the third quarter.

### *Overweight consumption and high yield stocks*

In view of high uncertainty on global economic growth, investors should continue to overweight China consumption stocks and high yield stocks in the third quarter. Our top picks are China Yurun Food (1068), Mengniu Dairy (2319), Dongfeng Motor (489), Regal REIT (1881), Hang Seng Bank (11) and BOC Hong Kong (2388). The last two companies will also benefit from the expansion of Renminbi business in Hong Kong in the long run. On the other hand, we also like telecom equipment supplier ZTE Corp (763) and gold producer Zijin Mining (2899). The former is the key beneficiary of the integration of telecom, TV and internet networks in China whilst the latter is massively undervalued compared to peers.

**Research Team**  
(852) 2218 2828  
www.guococap.com

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## MARKET REVIEW

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### *Growing uncertainty about the global economic recovery*

Worries about sovereign debt problems in Europe and slowdown in Chinese economy continuously put pressure on equity markets in developed countries and China in June. Dow, Nasdaq, FTSE 100, Nikkei 225 plunged 3.6%-6.5% whilst the Shanghai SE Composite Index lost 7.5%. Risk adverse investors poured money into bonds dragging the U.S. 10-year treasury yield to below 3% for the first time since April 2009. Gold price hit a record high of US\$1,258 an ounce on June 18. Asian stock markets ended higher on weakening U.S. dollar. British pound, Japanese yen and Chinese yuan rose 3.0%, 2.9% and 0.7% respectively against the U.S. dollar whilst the euro fell 0.3%. The benchmark indexes for stock markets in Singapore, Malaysia, Thailand, Korea and Indonesia advanced 2.3%-6.3%. Hang Seng Index added 1.8% but HSCEI dropped a meager 0.2%.

### *Chinese telecom and local property stocks outperformed*

Despite the decline in market turnover, Hang Seng Index closed up 1.8% in June led by telecom and local property stocks. Progress in integration of telecom, internet and TV networks boosted share prices of telecom players. China Unicom (762), China Mobile (941) and China Telecom (728) surged 10.5%, 6.1% and 4.7% respectively. Other red chips also outperformed the benchmark index. China Resources Enterprise (291), China Merchants (144) and CNOOC (883) soared 6.8%-8.4%. Latest land auction results in Hong Kong showing that property developers remained bullish on the luxury residential market. Sino Land (83) and Hang Lung Properties (101) soared 9.7%-10.0% whilst Cheung Kong (1), SHK Properties (16), Swire Pacific (19) and New World Development (17) climbed 1.9%-4.6%. Exported-oriented counters suffered from Europe's debt crisis. Esprit (330) and Foxconn (2038) shrank 7.5% and 10.0% respectively. Tencent (700), the worst performing constituent of the Hang Seng Index, sank 12.1% on fears of earnings slowdown.

### *Power companies rallied at the expense of coal producers*

The HSCEI was virtually unchanged in June. However, power companies rallied at the expense of coal producers since the National Development and Reform Commission put a cap on coal price. China Resources Power (836), Huaneng Power (902) and Datang Power (991) gained 14.0%, 7.9% and 4.3% respectively. China Coal (1898), China Shenhua (1088) and Yanzhou Coal (1171) lost 7.4%, 9.2% and 15.6% respectively. Oil and insurance companies edged up slightly. Large Chinese banks showed little change. Performance of Chinese property developers was mixed. Automobile, shipping, cement, steel and non-ferrous metal companies underperformed the HSCEI.

### *Strong fundamental factors stimulated consumption stocks*

China's consumption grew rapidly this year, thanks to increased government subsidies and fast growing salaries. Retail sales value surged 18.2% yoy in the first five months of 2010 compared to 15.5% yoy for the full year of 2009. Hence, food & beverage manufacturers and department store operators massively outperformed the stock market in June. China Yurun Food (1068), Mengniu Dairy (2319), Tingyi (322), Want Want China (151), Intime Department Store (1833), New World Department Store (825) and Maoye Int'l (848) climbed 7.4%-17.1%.

## Stock Performance Summary for June 2010

Sector	Stocks	% chg in share price in Jun 10	Reasons
	Hang Seng Index (20,128)	+1.8	Decline in both U.S. and China stock markets
	HSCEI (11,466)	-0.2	
<b>Outperform</b>			
Miscellaneous	China Resources Power (836), HK & China Gas (3)	+12 to +14	NDRC ordered coal price-freeze
	CNOOC (883), China Merchants (144), China Resources Enterprise (291)	+7 to +8	
Telecom	China Mobile (941), China Unicom (762), China Telecom (728)	+5 to +10	Unicom achieved better than expected growth in handset sales and 3G subscribers
Small PRC bank	CITIC Bank (998), Minsheng Bank (1988), BoComm (3328)	+5 to +7	
Power	Huaneng Power (902), Datang Power (991)	+4 to +8	NDRC ordered coal price-freeze
HK property	Cheung Kong (1), SHK Properties (16), Hang Lung Properties (101), Swire Pacific (19), New World Development (17), Sino Land (83)	+2 to +10	Better than expected land auction results stimulated residential sales in the secondary market
Oil	PetroChina (857), Sinopec (386)	+3	Increase in ex-factory price of natural gas
Insurance	China Life (2628), Ping An Insurance (2318), PICC P&C (2328), China Pacific Insurance (2601)	+1 to +5	Rising wages in China will boost premium income
<b>In line/ Mixed</b>			
HK bank	HSBC (5), BOC Hong Kong (2388), Hang Seng Bank (11)	+1 to +2	High dividend yield
Large PRC bank	ICBC (1398), CCB (939), BOC (3988)	-1 to +2	
China Property	China Overseas (688), Country Garden (2007), Agile Property (3383), Poly HK (119)	-3 to -8	Property sales volume remained sluggish while property prices stayed high
	China Resources Land (1109), Longfor (960), R&F (2777), Sino Ocean Land (3377)	-1 to +1	
	Shimao (813), Evergrande (3333)	+5 to +10	
<b>Underperform</b>			
Non-ferrous metal	Chalco (2600), Jiangxi Copper (358), MCC (1618)	-5 to -9	
Automobile	Dongfeng Motor (489), BYD Company (1211)	-3 to -11	Decline in China's auto sales and production in May
Shipping	China Cosco (1919), China Shipping Dev (1138)	-7	Decline in Baltic Dry Index
Pharmaceutical	Sinopharm (1099)	-7	NDRC drafted new plan to curb drug prices
Coal	China Shenhua (1088), China Coal (1898), Yanzhou Coal (1171)	-7 to -16	NDRC ordered coal price-freeze
Miscellaneous	Foxconn (2038), Tencent (700), Angang Steel (347), Anhui Conch (914)	-10 to -15	Worries about earnings slowdown in 2H 2010



12/F, The Center  
99 Queen's Road Central  
Hong Kong  
Tel: (852) 2218 2865  
Fax: (852) 2285 3160

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