

Market Strategy

March 2010

MARKET OUTLOOK

Bullish on the HSI with short-term target at 23,000

The Hang Seng Index closed above the 50-day moving average on the first day of March. Share prices of the ten largest China property stocks have already rebounded 20% from the trough. CMB (3968) and BoComm (3328) rallied after announcement of the terms of rights issue. Oil and gold prices ended higher in February amid a strengthening U.S. dollar. All these are pointing to a good possibility that the worst has been over. We expect the Hang Seng Index to test 23,000 within the next two months, led by H-shares, driven by the release of satisfactory corporate earnings and robust first-quarter GDP growth in China.

Overweight China banking and properties

The ten largest China property stocks are presently trading at an average 2010 PER of 13x, 2010 P/B ratio of 2.0x and 28% discount to NAV. Except China CMB (3968), China banks are trading at an average 2010 PER of 10x. In our view, current valuations of China banking and property sectors have fully discounted the dilution effect of the proposed fund raising exercises and 20% drop in contracted property sales revenue, respectively. Earnings outlook for both sectors looks promising this year. We believe it is the right time to buy China banking and property stocks. Our top picks are ICBC (1398), CCB (939), China Resources Land (1109) and Sino-Ocean Land (3377).

Overweight Hong Kong properties amid record low mortgage rate

The chairman of the U.S. Federal Reserve pledged to hold interest rate low for the foreseeable future. This will undoubtedly prop up asset prices in Hong Kong under the pegged system. The HKSAR government has taken several steps to increase land supply but still the problem of housing shortage remains intact. We do expect mass residential price to rise 10-15% this year and maintain our overweight position on Hong Kong property stocks. Cheung Kong (1), SHK Properties (16) and Wharf (4) continue to be our top favourites with target prices of \$112.1, \$123.3 and \$45.4 respectively.

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MARKET REVIEW

Hong Kong stock markets rebounded amid the exit of central banks' policies

Although the Federal Reserve unexpectedly lifted discounted rate by 25 basis points to 0.75% and the People's Bank of China raised reserve requirement ratio for commercial banks from 16.0% to 16.5%, the stock markets in U.S., UK, China and Hong Kong ended higher in February following a heavy sell-off in January. Stock markets in France and Germany further declined due to growing concerns of debt crisis in Greece and weakening euro and pound sterling against U.S. dollar. For the month of February, DJIA and FTSE 100 rose 2.6% and 3.2% respectively. Shanghai SE Composite Index added 2.1%. Hang Seng Index closed up 2.4%. Light crude oil futures price soared 9.3% to around US\$80 a barrel. Spot gold price advanced 3.4% to US\$1,117 per ounce. Both euro and pound sterling dropped more than 5% against U.S. dollar since the beginning of the year.

China and Hong Kong property stocks rallied

Fuelled by the increase of Hong Kong's mass residential price by 5% in the first two months of the year, HSBC's (5) cut in mortgage rate to record low, overwhelming pre-sale response in SHK Properties' (16) Yoho Midtown at Yuen Long and better than expected land auction results, Hong Kong property stocks outperformed the market in February. SHK Properties (16), Henderson Land (12), Hang Lung Properties (101), New World Development (17) and Sino Land (83) gained 7%-14% whilst Cheung Kong (1) and Wharf (4) added 3%-4%. Hong Kong banking stocks including HSBC (5), Hang Seng Bank (11) and BOC Hong Kong (2388) closed up 3%-7% driven by expectation of satisfactory financial results for 2009. China property stocks rallied amid negative news flow because their valuations turned attractive again after a 35% drop in share price from 12-month highs. Ten largest China property stocks, except for Evergrande (3333), increased an average of 9%.

Insurance stocks underperformed

HSCEI rose 0.4% in February. China Oilfield Services (2883), the top gainer among the members of the HSCEI, jumped 15% stimulated by higher-than-expected production target of CNOOC (883) in 2010. Auto and shipping counters also outperformed the benchmark index on the back of China's strong car sales and foreign trade in January. Dongfeng Motor (489) and BYD Company (1211) climbed 6%-11%. China Cosco (1919), China Shipping Development (1138) and CSCL (2866) advanced 4%-7%. Cement producers like Anhui Conch (914) and CNBM (3323) experienced a technical rebound of 3%-7%. Defensive plays such as telecom, power, power equipment and railway related companies edged up by 2%-6%. Potential disposal of Ping An A-shares in March by major shareholders weighed on insurance stocks in Hong Kong. China Life (2628), Ping An Insurance (2318) and PICC P&C (2328) fell 1%-3%. Performance of China banking and non-ferrous metal stocks were mixed. CMB (3968) and BoComm (3328) surged 6%-8% as the announcement of rights issue removed uncertainties on fund raising. However, ICBC (1398), CCB (939) and CITIC Bank (998) plunged 1%-4%. Zijin Mining (2899) rose 5% on higher gold price. Chalco (2600) tumbled 4% partly due to the issue of profit warning.

Stock Performance Summary for February 2010

Sector	Stocks	% chg in share price in Feb 10	Reasons
	Hang Seng Index (20,608)	+2.4	
	HSCEI (11,543)	+0.4	
Outperform			
HK Property	SHK Properties (16), Henderson Land (12), New World Development (17), Sino Land (83), Hang Lung Properties (101)	+7 to +14	Encouraging pre-sales of large-scale residential projects, lower mortgage rates and good land auction results
	Cheung Kong (1), Wharf (4), Swire Pacific (19)	+2 to +4	
China Property	China Overseas Land (688), Shimao (813) China Resources Land (1109), Longfor (960) Country Garden (2007), Sino-Ocean Land (3377) Poly HK (119), Guangzhou R&F (2777)	+4 to +21	Negative news about real estate market were fully digested after a 35% drop in share prices from peak levels
Auto	Dongfeng Motor (489), BYD Company (1211)	+6 to +11	Strong car sales in Jan
Airline	Cathay Pacific (293), Air China (753)	+4 to +13	Recovery in passenger traffic
Port/Shipping	China Cosco (1919), CSCL (2866), China Shipping Development (1138), China Merchants (144), Cosco Pacific (1199)	+4 to +7	Strong rebound in China's foreign trade in Jan 2009
HK Banking	HSBC (5), BOC Hong Kong (2388), Hang Seng Bank (11)	+3 to +7	Betting on satisfactory financial results
Cement	Anhui Conch (914), CNBM (3323)	+3 to +7	Technical rebound
Telecom	China Mobile (941), China Unicom (762), China Telecom (728)	+4 to +6	Defensive stocks
Power/ Power equipment	China Resources Power (836), Datang Power (991), Huaneng Power (902), Shanghai Electric (2727)	+2 to +6	Defensive stocks
Railway	China Railway Group (390), China Railway Construction (1186)	+3 to +4	Defensive stocks
In line/ Mixed			
China Banking	CMB (3968), BoComm (3328)	+6 to +8	Concerns of capital raising
	ICBC (1398), CCB (939), BOC (3988), CITIC Bank (998)	-4 to +1	
Oil	CNOOC (883), China Oilfield Service (2883)	+11 to +15	High capex and production target of CNOOC in 2010
	PetroChina (857), Sinopec (386)	-0 to -1	
Coal	China Coal (1898), Yanzhou Coal (1171)	+4 to +6	Increase in contract coal price for 2010
	China Shenhua (1088)	+0	
Non-ferrous metal and steel	Angang Steel (347), Zijin Mining (2899)	+5 to +6	Strong US dollar weighed on commodity prices
	Maanshan Iron & Steel (323), CMOC (3993), Jiangxi Copper (358), Chalco (2600)	-4 to +1	
Underperform			
Insurance	China Life (2628), Ping An Insurance (2318) PICC P&C (2328)	-1 to -3	Potential disposal of Ping An A-shares in March
Miscellaneous	Foxconn (2038), Beijing Airport (694), Tsingtao Brewery (168)	-4	N/A



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