

Market Strategy

May 2010

MARKET OUTLOOK

Range trading for HSI between 20,000 and 22,000

China's tightening measures on property market and further increase in banks' reserve requirement ratio will continue to dampen market sentiment in May although current valuation of Hong Kong's stock market is below historical average. China may also raise interest rate later this month if inflation rate in April is higher than expected. Considering the policy uncertainty and absence of positive news flow, we believe the Hang Seng Index will be range trading between 20,000 and 22,000 in May/June. Investors should adopt short term trading to maximize return in the second quarter.

Neutral on Chinese banks and property developers

Valuation of Chinese banks, in terms of price earnings multiple and price-to-book ratio, is attractive in our view but a meaningful rally in share prices is unlikely to happen before completion of the proposed fundraising exercises. Leading Chinese property developers are currently trading at an average discount of 45% to NAV that should have discounted a 20-25% drop in residential prices in the main cities of China. However, we do not expect to see a strong recovery in share prices until the decline in residential price is confirmed.

Overweight defensive and consumption stocks

In the near term, we believe defensive and consumption stocks will outperform the benchmark indexes. This includes telecom, food & beverage, retailing, automobile and pharmaceutical sectors. Our top picks are China Unicom (762), Mengniu Dairy (2319), Hengan (1044), Dongfeng Motor (489) and Sinopharm (1099). For other H-shares, we prefer China Shenhua (1088), Angang Steel (347) and Zijin Mining (2899).

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

4 May 2010

MARKET REVIEW

Hang Seng Index retreated on Greece's debt crisis and China's tightening measures

The U.S. stock markets continued to move up in April on the back of a recovery in corporate earnings and the economy. Crude oil futures price surged 3% to over US\$86 a barrel whilst spot gold prices soared 6% to US\$1,179 an ounce. However, growing market concerns over Greece's debt crisis weighed on euro and equity markets in Europe. FTSE 100, CAC 40 and DAX retreated 2.2%, 4.0% and 0.3% respectively. Euro fell 1.9% against the U.S. dollar. Most Asian stock markets managed to close higher in April but China and Hong Kong lagged behind given the launch of tightening measures in the property market. Shanghai SE Composite Index plunged 7.7% to finish at 2,870, the lowest in seven months. The Hang Seng Index and the HSCEI declined 0.6% and 1.7% respectively.

Increasing policy risk caused heavy sell off in China and Hong Kong property stocks

Following announcement of strong GDP growth for the first quarter, the Chinese government had promptly imposed stringent measures to cool overheated residential market. A substantial part of the new measures were aimed to curb investment demand by tightening mortgage lending and lifting mortgage rates on buying a second home. In addition, the Chinese government would substantially increase land supply for housing development by 142% to approximately 185,000 hectares this year. As a result of these unprecedented policies, market sentiment turned bearish so that property sales volume in the main cities of China dropped some 50% in the second half of April. Some leading property developers actively extended funding sources beyond commercial banks. Evergrande (3333), Country Garden (2007) and Agile Property (3383) raised a total of US\$2.15bn from the issue of senior notes. Share prices of the ten largest PRC property stocks, except for Evergrande (3333), tumbled an average of 14% in April. In Hong Kong, the government moderately increased land supply for private residential use and issued new guidelines on property presales. As the fundamentals of Hong Kong's property market remained sound, share prices of the Hong Kong property stocks dropped only 3%-9%.

Yanzhou Coal and China Unicom substantially outperformed

Among the constituents of the HSI and HSCEI, heavily weighted HSBC (5), China Mobile (941) and CNOOC (883) edged up by 2%, 3% and 8% respectively. China Unicom (762) advanced 12% as investors chased laggard and defensive stock. Yanzhou Coal (1171) soared 19% because stronger than expected first quarter earnings triggered a positive re-rating. Insurance, power, auto, non-ferrous metal, shipping and port companies underperformed the benchmark indexes. BYD Company (1211) and Dongfeng Motor (489) plunged 9%-10% simply due to profit taking rather than any change in fundamentals. China Life (2628) and PICC P&C (2328) lost 4%-5% whilst Ping An Insurance (2318) added 1% thanks to achievement of better-than-expected first quarter earnings. Rising gold price sent Zijin Mining (2899) higher by 1% while Chalco (2600) and Jiangxi Copper (358) shrank 3%-5% on falling copper and aluminum prices. Cosco Pacific (1199) closed down 9% due to placement of new shares at a deep discount to share price. Companies with relatively high business exposure to Europe were adversely affected by Greece's lingering debt problem. Hutchison (13) and Esprit (330) therefore fell 5%-7%. Performance of Chinese banks was mixed. China Minsheng Bank (1988) gained 5% fuelled by strong earnings growth of 71% yoy in the first quarter. CMB (3968) and CITIC Bank (998) plunged 8%-10%.

Stock Performance Summary for April 2010

Sector	Stocks	% chg in share price in Apr 10	Reasons
	Hang Seng Index (21,108)	0.6	Decline in A-share market
	HSCEI (12,181)	1.7	
Outperform			
HK Property	Yanzhou Coal (1171)	+19	Strong quarter earnings caused re-rating of Yanzhou Coal
	Tencent (700), CNOOC (883), Zhejiang Express (576), Air China (753)	+5 to +10	
In line/ Mixed			
Telecom	China Mobile (941), China Unicom (762)	-2 to -6	Investors chased laggards
	China Telecom (728)	+12	
Insurance	Ping An Insurance (2318)	+1	Ping An posted better than expected quarter earnings
	China Life (2628), PICC P&C (2328)	-4 to -5	
Power	Huaneng Power (902)	+0	
	Datang Power (991), China Res Power (836)	-4 to -6	
China Banking	China Minsheng Bank (1988)	+5	Strong quarter earnings caused re-rating of Minsheng Bank
	ICBC (1398), CCB (939), BOC (3988), BoComm (3328)	-3 to +1	
	CMB (3968), CITIC Bank (998)	-8 to -10	
Oil, Coal	China Coal (1898), China Shenhua (1088), PetroChina (857), Sinopec (386)	-1 to +1	
Non-ferrous metal	Zijin Mining (2899)	+1	Rising gold price supported Zijin performance
	Jiangxi Copper (358), Chalco (2600), MCC (1618)	-3 to -5	
Railway	China Railway (390), China Railway Const (1186)	-3 to +2	
HK Banking	HSBC (5), HSB (11), BOC HK (2388)	-2 to +2	
HK Utilities	CLP (2), HK Electric (6), HK & China Gas (3)	-0 to -2	
Underperform			
China Property	China Overseas Land (688), Shimao (813) China Resources Land (1109), Longfor (960) Country Garden (2007), Sino-Ocean Land (3377) Agile (3383), R&F (2777), Poly HK (119)	-11 to -21	PRC Government tightened mortgage policies and increased land supply to curb investment demand
HK Property	Cheung Kong (1), SHK Properties (16), Henderson Land (12), Swire Pacific (19), New World Development (17), Sino Land (83), Hang Lung Properties (101), Wharf (4)	-3 to -9	HK Government issued new guidelines on property presales
Auto	BYD Company (1211), Dongfeng Motor (489)	-9 to -10	Profit taking
Shipping/Port	China Cosco (1919), China Shipping Dev (1138)	-1 to -7	
	China Merchants (144), Cosco Pacific (1199)	-4 to -9	
Misc	Hutchison (13), Esprit (330), CITIC Pacific (267)	-5 to -7	Relatively high business exposure to Europe
	CNBM (3323), Angang (347), Foxconn (2038)	-13 to -14	Angang's earnings for 2009 below market expectation



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

GCAP Research is available on www.guococap.com

This report is for information only and is not to be construed as investment advice or as an offer to buy or sell securities. While the report is compiled using sources believed to be reliable, no assurance or guarantee is given regarding its accuracy or completeness. Neither GuocoCapital nor any other Guoco Group companies, (nor any employees or other persons connected with any of them) accepts any responsibility or liability arising from any use of this report. To the extent permitted under applicable law, the above-mentioned companies or individuals may have used the research materials before publication. However, it is hereby declared that neither GuocoCapital nor the writer, at the time of writing, has interest in any of the securities mentioned in this report.