

Market Strategy

November 2009

MARKET OUTLOOK

Limited upside for the HSI in Nov/Dec

Worries about the withdrawal of stimulus packages by central banks around the world and possibility of a double-dip recession in the U.S. will undoubtedly limit the upside of Hong Kong's equity prices in the near term. Traded at 2009 PER of 17x against the 10-year average of 16x, current valuation of the Hang Seng Index is fair in our view. We stick to our year-end target of 21,600 and expect the benchmark index to move between 20,500 and 22,500 for the rest of the year.

Long term fundamentals remain positive

Latest economic data showing that the recovery of China's economy is on track. GDP growth of 8% should be highly achievable this year and a faster growth rate for 2010 is widely anticipated. A fundamental change in China's fiscal and monetary policies is unlikely to happen before February/March 2010. Chinese leaders recently emphasized that managing inflation expectations was as important as sustaining economic growth. To ease inflation pressure arising from the influx of hot money into China, the Chinese government has resumed issuing quotas under the QDII program in late October, the first time since May 2008. We expect to see further expansion of the investment quotas next year that will bring a good support to equity prices in Hong Kong. The aggregate balance of the Hong Kong's banking system rose from \$184 billion at end-September to \$248 billion at end-October, reflecting a continuous inflow of capital. In conclusion, we remain optimistic about Hong Kong's stock market in the long term and maintain our forecast for the Hang Seng Index at 25,600 by end-2010.

Continue to overweight China consumption stocks

In our view, China consumption stocks are less vulnerable to the exit strategy of central banks and excess production capacity problem in China. Internal consumption will be the engine of economic growth in the medium-to-long term. We continue to recommend an overweight position on consumption stocks including auto, property and food & beverage sectors. We also like China financial stocks given their strong earnings growth momentum. Our top picks are ICBC (1398), CCB (939), China Life (2628), China Overseas Land (688), Dongfeng Motor (489) and Mengniu Dairy (2319).

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

3 November 2009

MARKET REVIEW

Partial withdrawal of stimulus packages by central banks

The U.S. economy posted stronger-than-expected GDP growth of 3.5% in the third quarter. Following the Bank of Israel's rate hike in August, Australia and Norway also lifted their key interest rates by a quarter point in October whilst India raised statutory liquidity ratio for commercial banks by 100 basis points. Worries about the withdrawal of stimulus packages by central banks around the world together with the U.S. dollar rebound caused global equity markets to fall from 12-month highs in the last week of October. For the whole month, DJIA was flat, Nasdaq, FTSE 100 and Nikkei 225 closed down 3.6%, 1.7% and 1.0% respectively. Crude oil futures price rose 9% to US\$77 a barrel. Spot gold price advanced 4% to US\$1,045 an ounce. However, Hong Kong and China stock markets managed to close higher on the back of strong GDP growth in China. Shanghai SE Composite Index edged up by 7.8%. Hang Seng Index and HSCEI gained 3.8% and 7.7% respectively. Average daily turnover of the stock market increased to \$65.5bn from \$60.4bn in September.

China banking, insurance, auto, property and oil stocks outperformed

China banking and insurance stocks substantially outperformed the HSCEI in October due to better than expected third quarter earnings. Except BoComm (3328), share prices of China banking and insurance stocks soared 8%-18%. Upstream oil companies like CNOOC (883) and PetroChina (857) surged 10%-15% on rising crude oil price. Ten largest China property stocks, except China Overseas Land (688) and Poly HK (119), advanced 8%-13% driven by higher than expected property sales revenue in September. Robust car sales in September boosted auto stocks. BYD Company (1211) and Dongfeng Motor (489) added 13%-14%. Foxconn (2038), the best performing constituent of the HSI, climbed 37%.

Hong Kong banking stocks faced profit-taking pressure

Hong Kong property stocks moved in line with the HSI although the government expressed great concern about skyrocketing residential prices. Henderson Land (12), the best performing blue-chip property company, went up 9% after accepting the land premium of \$9.6bn for its residential project at Lok Wo Sha. Hong Kong banking stocks underperformed the HSI primarily due to profit taking. Performance of shipping and coal counters was mixed. China Coal (1898) and Yanzhou Coal (1171) both increased 10% whilst China Shenhua (1088) gained 5%. China Shipping Development (1138) climbed 14% but CSCL (2866) rose less than 1%. Telecom, steel, non-ferrous metal, power, power equipment, downstream oil, cement and railway stocks all underperformed the HSCEI in October.

Stock Performance Summary for October 2009

Sector	Stocks	% chg in share price in Oct 09	Reasons
	Hang Seng Index (21,753)	+3.8	Healthy growth in China's economy in 3Q 2009
	HSCEI (12,769)	+7.7	
Outperform			
Miscellaneous	Foxconn (2038)	+37	Improving U.S. economy
	China Resources (291)	+17	Corporate restructuring
Auto	BYD Company (1211), Dongfeng Motor (489)	+13 to +14	Strong auto sales in Sep
Upstream Oil	CNOOC (883), PetroChina (857)	+10 to +15	Rising crude oil price
China banking	ICBC (1398), CCB (939), BOC (3988), CMB (3988), CITIC Bank (998)	+8 to +18	Strong quarter earnings
Insurance	China Life (2628), Ping An Insurance (2318), PICC P&C (2328)	+8 to +13	Strong quarter earnings
China property	CR Land (1109), R&F (2777), Agile (3383), Sino-Ocean Land (3377), Shimao (813), Country Garden (2007), Shui On Land (272)	+8 to +13	Better than expected property sales in China in Sep
	COLI (688), Poly HK (119)	-1 to +2	
In line/ Mixed			
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 +9	Skyrocketing luxury residential price
Shipping	China Shipping Development (1138)	+14	Rising BDI Index
	China Cosco (1919), CSCL (2866)	+1 to +6	
Coal	China Coal (1898), Yanzhou Coal (1171), China Shenhua (1088)	+5 to +10	Expectation of rising coal price in the long term
Underperform			
HK banking	BOC HK (2388)	+7	
	HSBC (5), Hang Seng Bank (11), BoEA (23)	-0 to -3	
Metal	Angang Steel (347), Maanshan Iron (323), Chalco (2600), Jiangxi Copper (358), CMOC (3993), Zijing Mining (2899)	+1 to +5	Worries about oversupply in production capacity
Downstream Oil	Sinopec (386), Sinopec Shanghai (338)	-2 to +2	Rising crude oil price
Telecom	China Mobile (941), China Unicom (762), China Telecom (728)	-2 to -7	Concern about price war and increased competition
Power	Datang Power (991), Huaneng Power (902), China Resources Power (836)	-1 to -9	High coal price and little chance of tariff increase
Cement	Anhui Conch (914), CNBM (3323)	-1 to -6	Excess industry capacity
Power Equipment	Harbin Power (1133), Shanghai Electric (2727)	-1 to +1	
Railway/Infra	China Railway Construction (1186), China Railway Group (390), CCCC (1800)	-6 to +2	Lack of share price catalyst
Port operator	Cosco Pacific (1199), China Merchants (144), Hutchison (13), CITIC Pacific (267)	-1 to -2	Slow recovery in foreign trade
HK Utilities	CLP (2), HK Electric (6), HK & China Gas (3)	-1 to -4	Defensive stocks



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.quococap.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.