

Market Strategy

October 2009

MARKET OUTLOOK

October correction creates buying opportunity

The U.S. stock markets witnessed a correction of 3-4% over the last two weeks while the 10-year bond yield declined from 3.5% to 3.2% primarily due to worries about an economic slowdown. U.S. jobless rate reached a 26-year high of 9.8% in September. In our view, the U.S. stock markets have run ahead of the economy and may face selling pressure in October especially after a strong rally in the last six months. In late September, the Chinese government announced sweeping curbs on surging investment in some industries including steel, cement and polysilicon etc. Negative news flow from the U.S. and China will inevitably affect market sentiment in the near term leading to declines in Hong Kong's equity prices. We may see the Hang Seng Index to dip below 20,000 or even 19,000 this month. Nevertheless, this creates buying opportunity for long-term investors given our bullish stance on China's economy and corporate earnings for 2010. China will release third-quarter economic data on October 22 that should be satisfactory. We maintain our forecast for the Hang Seng Index at 21,600 by end-2009 and 25,600 by end-2010. 19,000-19,500 will be a good-entry point.

Overweight China consumption stocks

China has little room to change its relatively loose monetary policy and proactive fiscal policy before seeing signs of recovery in exports and return of inflation. Due to growing concerns about over-investment, we believe investors' attention will focus on consumer plays in the fourth quarter since internal consumption will be the engine of economic growth. Therefore, we recommend investors to overweight China banks, properties, auto, retailing and food & beverage sectors. Our top picks are ICBC (1398), CCB (939), China Overseas Land (688), China Resources Land (1109), Shimao Property (813), Dongfeng Motor (489), Anta Sports (2020), China Dongxiang (3818) and Mengniu Dairy (2319). We also like Sinopec (386), CNBM (3323) and China Cosco (1919).

Underweight Hong Kong banks and properties

The outperformance of Hong Kong banks and properties in September was partially attributable to the weak U.S. dollar and booming property prices. However, the number of property sales transaction has been slowdown in the past two weeks following a sharp increase in mass residential price by 30% year-to-date. We believe the pullback of the U.S. stock markets will intensify profit-taking pressure on traditional blue chips. In other words, we expect the Hang Seng Index to underperform the HSCEI in coming weeks.

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MARKET REVIEW

Global stock markets rallied amid weakening U.S. dollar

Major stock markets in the U.S. and Europe advanced for the third straight month in September given the improved outlook for the global economy. Major international currencies including the euro, the yen and the Australian dollar rose against the U.S. dollar by 2.2%, 3.6% and 5.6% respectively. Gold price soared over US\$1,000 per ounce. The average crude oil price was steady at US\$70 a barrel. Shanghai SE Composite Index saw a technical rebound of 4.2% after the August's deep correction. Hong Kong shares rallied but market turnover declined as investor focus shifting to the IPOs. The Hang Seng Index reached a 12-month high of 21,768 in mid-September and closed up 6.2% at 20,955. The HSCEI gained 5.1% to finish at 11,858.

Banking and property stocks outperformed

Banking stocks outperformed the benchmark indexes in September as investors raised confidence in recovery of China's economy. HSBC (5), BOC Hong Kong (2388), Bank of East Asia (23), ICBC (1398) and BOC (3988) surged 8%-12%. The skyrocketing price of luxury residential properties in Hong Kong undoubtedly benefited property developers. Wharf (4) and Hang Lung Properties (101) added 18% whilst other blue-chip property stocks climbed 7%-13%. China property stocks also performed well in September although the Chinese government expressed a great concern about rising land prices. Shimao Property (813), Greentown (3900) and Hopson (754) increased 14%-18% whilst other leading China property developers, except Country Garden (2007), gained 4%-8%. Rising gold price sparked a buying spree in related counters. Zijin Mining (2899) rose 17%. Jiangxi Copper (358) and CMOC (3993) both went up 7%. BYD Company (1211) and China Resources Enterprise (291), the best performing constituents of the HSCEI and the HSI, jumped 31% and 24% respectively.

Defensive stocks lagged behind

Insurance and coal sectors moved in line with the HSECI in September but telecom, oil, steel, shipping, power and railway stocks lagged behind. China Mobile (941) and China Unicom (762) were almost unchanged due to increased possibility of price war. Stable crude oil price at US\$60-70 a barrel capped performance of oil stocks. CNOOC (883), PetroChina (857) and Sinopec (386) all increased 2%. China Cosoc (1919), China Shipping Development (1138) and CSCL (2866) varied less than 1% although the Baltic Dry Index further declined 10% in September after a drop of 28% in August. Angang Steel (347) and Maanshan Iron & Steel (323) retreated 1%-2% on worries about excess capacity in the industry. Power companies including Datang Power (991), Huaneng Power (902) and China Resources Power (836) plunged 2%-6% although China's power generation grew 8.2% yoy in August. China Railway Construction (1186) tumbled 10%.

Stock Performance Summary for September 2009

Sector	Stocks	% chg in share price in Sep 09	Reasons
	Hang Seng Index (20,955)	+6.2	Weakening U.S. dollar
	HSCEI (11,858)	+5.1	
Outperform			
Miscellaneous	BYD Company (1211), Li & Fung (494), China Resources (291)	+21 to +31	
HK banking	HSBC (5), BOC HK (2388), BoEA (23)	+9 to +12	
HK property	Hang Lung Properties (101), Wharf (4)	+18	Low interest rate and strong investment demand boosted luxury residential prices
	Cheung Kong (1), SHK Prop (16), Swire (19), New World Dev (17), Henderson Land (12)	+7 to +13	
Cement	Anhui Conch (914), CNBM (3323)	+5 to +11	Expectation of strong demand and rising cement price in 4Q
Non-ferrous metal	Zijing Mining (2899)	+17	Weak US dollar gave strong support to commodity prices
	Jiangxi Copper (358), CMOC (3993)	+7	
	Chalco (2600)	+3	
In line/ Mixed			
China banking	ICBC (1398), CCB (939), BOC (3988), BoComm (3328), CMB (3968), CITIC Bank (998)	+2 to +10	Expectation of strong growth in new yuan loan in September
China property	Shimao (813), Greentown (3900), Hopson (754)	+14 to +18	(i) Rising land price and steady property sales in Aug/Sep (ii) Growing government concern on high land price
	COLI (688), CR Land (1109), R&F (2777), Agile (3383), Shui On Land (272)	+4 to +8	
	Country Garden (2007)	-12	
Insurance	China Life (2628), Ping An (2318), PICC (2328)	+3 to +9	
Coal	China Coal (1898), Yanzhou Coal (1171)	+1 to +3	Expectation of rising coal price in the medium-to-long term
	China Shenhua (1088)	+8	
Power	Shanghai Electric (2727)	+5	
Equipment	Harbin Power (1133)	-5	
Underperform			
Telecom	China Mobile (941), China Unicom (762)	0 to +1	Concern about price war and increased competition
	China Telecom (728)	-8	
Steel	Angang Steel (347), Maanshan Iron & Steel (323)	-1 to -2	Concern oversupply in capacity
Railway/Infra	China Railway Construction (1186), China Railway Group (390), CCC (1800)	-1 to -10	
Power	Datang Power (991), Huaneng Power (902), China Resources Power (836)	-2 to -6	Positive growth in power generation in Aug
Shipping	China Shipping Development (1138), China Cosco (1919), CSCL (2866)	-1 to +1	Baltic Dry Index fell 28% in Aug and 10% in Sep
Oil	CNOOC (883), PetroChina (857), Sinopec (386)	+2	Falling oil price in late Sep
Port operator	Cosco Pacific (1199), China Merchants (144)	-5 to +2	No improvement in China's foreign trade
HK Utilities	CLP Holdings (2), HK Electric (6)	-2 to +1	



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