

# Market Strategy

**September 2009**

## MARKET OUTLOOK

### *Healthy short-term correction*

The sharp correction in the Shanghai stock market by more than 20% has dampened market sentiment and weighed on Hong Kong shares. Nevertheless, the latest economic data demonstrate that the recovery of China's economy is on track. Corporate earnings for the first half of 2009 are largely better than expected. A fundamental change in China's moderately loose monetary policy is unlikely before seeing signs of recovery in exports in late 2009 at the earliest. In addition to a mild economic recovery in developed countries like Japan, Germany, France and Australia in the second quarter, we believe the current weakness in Hong Kong's stock market is short-lived and provides a good buying opportunity for long-term investors.

### *Year-end target of 25,600 by 2010 giving a potential upside of 30%*

According to our estimates, the Hang Seng Index (at 19,715) is trading at 14.6x 2009 PER and 12.3x 2010 PER with earnings growth of 18% in 2010. This is compared to the historical average of 16.0x over the past ten years. As the global economy is on its way to recovery, despite at a slower pace, we believe the fair value of the HSI should be at 16x PE multiple, same as the historical average. This implies a year-end target of 21,600 by 2009 and 25,600 by 2010. Potential upside will be 30% over the next 12 months. In our view, the HSI should find a strong technical support at 19,000 whilst 19,000-19,500 will be a good entry point.

### *Continue to overweight China banks and Hong Kong properties*

China banks will be main contributors for earnings growth of the Hang Seng Index in 2010. We maintain our overweight recommendation on China banks with ICBC (1398) and CCB (939) as our top picks. Hong Kong property stocks are undervalued given no chance of rate hike in Hong Kong before mid-year 2010. Our favourites are SHK Properties (16), Henderson Land (12) and Wharf (4). After a deep correction in share prices, we have decided to upgrade China property stocks from underweight to neutral. On the other hand, we remain buyers on Sinopec (386), Dongfeng Motor (489), Angang Steel (347), Zijing Mining (2899), China Shenhua (1088), CNBM (3323) and Shimao Property (813).

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## MARKET REVIEW

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### *Sharp correction in A-shares weighed on Hong Kong stocks*

Major equity markets in the U.S. and Europe continued to rebound in August driven by more signs of recovery of the global economy. Japan, France and Germany all achieved positive GDP growth in the second quarter while the U.S. economy contracted by lower-than-expected 1.0%. However, the slowdown in new yuan loans, strictly enforcement of second home mortgage policy and acceleration in the pace of IPOs triggered a deep correction in China stock markets. The Shanghai SE Composite Index plunged 22% in August after a rise for five straight months. Hong Kong shares, particularly China stocks, therefore declined on profit taking. The Hang Seng Index and the HSCEI dropped 4.1% and 7.0% respectively last month while the average daily turnover increased slightly to \$70 billion.

### *China banks and oil stocks outperformed*

On the back of stronger than expected interim earnings, China banks outperformed the HSCEI. ICBC (1398), CCB (939), BOC (3988) and BoComm (3328) were down 2%-7%. Average crude oil futures price increased by 10% from US\$64.3 in July to US\$71.1 in August. CNOOC (883) retreated 2% whilst PetroChina (857) and Sinopec (386) both declined 7%. HK utilities counters were basically steady given the defensive nature of business. Li & Fung (494), Tencent (700), Cosco Pacific (1199) and HSBC (5), up 7%-13%, were unique gainers among the constituent stocks of the HSI and HSCEI. Coal, cement and telecom sectors showed mixed performance.

### *Heavy sell-off in HK and China property stocks*

Hong Kong and China property, steel, non-ferrous metal, power, power equipment, insurance and shipping sectors substantially underperformed the benchmark indexes in August. Top ten largest China property stocks tumbled 13%-26% due to worries about tightening credit and reduction in July property sales revenue. Hong Kong property developers lost 8%-16% although local residential prices continued to rise with a strong take-up in luxury residential properties. Steel producers like Angang Steel (347) and Maanshan Iron & Steel (323) fell 16%-21% on government warning of excess production capacity in the steel industry. Ping An Insurance (2318) and PICC P&C (2328) dropped 16%-20% because of a downturn in A-share market. China Life (2628), which attained higher than expected interim earnings, declined 5%. The fall in Baltic Dry Index by 28% and increase in container freight rate in August affected shipping stocks. China Cosco (1919) and China Shipping Development (1138) closed down 16%-17% whilst CSCL (2866) retreated 7%. Power and power equipment counters, except China Resources Power (836), lost 11%-19%.

## Stock Performance Summary for August 2009

Sector	Stocks	% chg in share price in Aug 09	Reasons
	Hang Seng Index (19,724)	-4.1	Shanghai SE Composite fell 22% in August
	HSCEI (11,278)	-7.0	
<b>Outperform</b>			
HK Utilities	HK Electric (6), CLP (2), HK & China Gas (3)	-3 to +1	Defensive stocks
Oil	CNOOC (883), PetroChina (857), Sinopec (386)	-2 to -7	Stabilized oil price above US\$70
China banking	ICBC (1398), CCB (939), BOC (3988), BoComm (3328), CMB (3968)	-2 to -7	Stronger than expected interim results
Railway	China Railway (390), China Railway Const (1186)	-4 to -7	Defensive business
Misc.	Dongfeng Motor (489), Zhejiang Express (576)	-2 to -3	N/A
	Li & Fung (494), Tencent (700)	+10 to +13	
<b>In line/ Mixed</b>			
Coal	China Coal (1898), Yanzhou Coal (1171)	-8 to -10	Better than expected interim results for China Shenhua
	China Shenhua (1088)	-1	
Cement	China National Building Material (3323)	-3	Concern oversupply in capacity
	Anhui Conch (914)	-13	
Telecom	China Unicom (762), China Telecom (728)	-2 to -3	Falling market share of China Mobile in new subscribers
	China Mobile (941)	-7	
HK Banking	BOCHK (2388), Hang Seng Bank (11)	-6 to -13	Better than expected interim results for HSBC and BOC HK
	HSBC (5)	+7	
<b>Underperform</b>			
China property	China Overseas Land (688), CR Land (1109), Guangzhou R&F (2777), Shui On Land (272), Country Garden (2007), Shimao (813), Agile (3383), Sino-Ocean Land (3377), Franshion (817)	-13 to -26	Concerns about tightening credit and restrictive mortgage policy in purchasing second home
HK property	Cheung Kong (1), Hang Lung Properties (101), SHK Properties (16), Henderson Land (12), New World Development (17), Sino Land (83)	-8 to -16	Worries about a slowdown in China's property market
Non-ferrous metal	Chalco (2600), Jiangxi Copper (358), Zijing (2899)	-9 to -10	N/A
	CMOC (3993)	-18	
Steel	Angang Steel (347), Maanshan Iron & Steel (323)	-16 to -21	Concern oversupply in capacity
Power equipment	Harbin Power (1133), Shanghai Electric (2727)	-12 to -16	N/A
Power	Datang Power (991), Huaneng Power (902)	-11 to -19	Satisfactory interim results
	China Resources Power (836)	-6	
Insurance	Ping An Insurance (2318), PICC P&C (2328)	-16 to -20	Sharp correction in Shanghai stock market
	China Life (2628)	-5	
Shipping	China Shipping Dev (1138), China Cosco (1919)	-16 to -17	Baltic Dry Index fell 28% in August
	CSCL (2866)	-7	



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