

# Market Strategy

**September 2010**

## MARKET OUTLOOK

*Mild recovery of manufacturing activities in both China and U.S. reduced recession risk*

Both U.S. and China recorded a rebound in August PMI after three straight months of decline. This together with fewer than expected job cuts in the U.S. helped assuage fears of a double dip recession leading to a recent rally in global stock market. Over the past three trading days, Dow Jones, Nasdaq, FTSE 100, DAX, CAC 40 and Nikkei 225 indexes all increased by 3.3%-5.7% whilst the main stock indexes in Taiwan, Singapore, Malaysia, Thailand, Korea and Indonesia rose 0.9%-2.8%. China and Hong Kong markets continuously lagged behind even compared with most Asian countries that were propped up by robust economic growth and appreciation of their currencies against the U.S. dollar. Relatively speaking, the downside risk of the Hong Kong market is limited in near term.

*Renminbi appreciation could be a catalyst*

Hang Seng Index has been trading sideways between 19,000 and 23,000 since August 2009. Considering stronger-than-expected corporate earnings for the first half, we believe the index will be well supported at 20,000. Any pull back should be treated as a buying opportunity. In terms of valuation, the index is presently trading at 2010 PER of 13.5x which is undemanding by historical standard. Appreciation of renminbi and news flow in relation to China's 12th Five-Year Plan could be catalysts to stock market for the rest of the year. According to market consensus, analysts' year-end target for the benchmark index is 24,600 giving a potential upside of around 20%.

*Neutral on China and Hong Kong property stocks*

It was reported that China's property sales volume increased significantly over the past two weeks while housing prices remained firm. Vanke, the largest property developer listed in A-share market, achieved record-high sales revenue of RMB 12bn in August. The recovery in property sales could push up share prices of Chinese property developers in near term. However, the rally may not be sustainable because China's tightening measures on property market will not be changed in our view and rising inflation rate may trigger expectation of interest rate hike in 4Q. Hong Kong's residential market is also subject to higher policy risk following a significant rise in land price. The possibility of the Hong Kong government taking drastic steps to cool the residential market should not be ignored. We recommend a neutral rating on both China and Hong Kong property stocks. On the other hand, we believe consumption-related stocks will continue to outperform the market.

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## MARKET REVIEW

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### *Stock markets in developed countries plunged on weak economic data*

Major equity markets in developed countries tumbled last month given a slowdown of the U.S. and Japan economies in the second quarter and growing concerns of a double dip recession. The U.S. housing market remained fragile despite low mortgage rates. Crude oil futures price dropped almost 9%. Risk adverse investors dominated the financial markets pushing the U.S. 10-year treasury yield to a 19-month low of 2.418%, spot gold price to a 2-month high of US\$1,247 per ounce and Japanese yen toward a 15-year high versus the U.S. dollar in late August. Dow and Nasdaq fell 4.3% and 6.2% respectively whilst Nikkei 225 lost 7.5%. CAC, DAX and FTSE decreased 4.2%, 3.6% and 0.6% respectively. The performance of stock markets in Asia was mixed amid strong economic growth for the Asian countries in the second quarter. Shanghai SE Composite Index was flat. Hang Seng Index and the H-shares index retreated 2.3% and 4.2% respectively.

### *Overall corporate earnings were ahead of market expectations*

Interim results and industry news were key drivers of index stocks performance in August. Hutchison (13), Cathay Pacific (293), PICC P&C (2328) and Dongfeng Motor (489) surged 11%-13% due to positive re-ratings after reporting stronger than expected interim earnings. China Life (2628) and Chalco (2600) shrank 10%-14% as their interim results disappointed investors. Overall, the corporate earnings were well ahead of market expectations. Interim earnings of the eight Chinese banks listed in Hong Kong increased by an average of 35% yoy in the first half of 2010. However, the requirement of bringing loans to trust companies back on to the balance sheet and tremendous fund raising plans continued to dampen market sentiment on Chinese banks. Except for ABC (1288), share prices of Chinese banks declined 2%-5%.

### *Shipping and coal stocks underperformed the HSCEI*

Rapid increase of Renminbi deposits in Hong Kong and PBOC's permission of overseas institutions investing yuan funds into interbank bonds in China gave a boost to BOC Hong Kong (2388), the clearing bank for Renminbi business in Hong Kong. BOC Hong Kong (2388) soared 3% during last month while HSBC (5) fell 5% given a gloomy outlook for the global recovery. The anticipation of slowing demand for coal and shipping in 4Q weighed on corresponding stocks. China Cosco (1919) and China Shipping Development (1138) sank 7%-10%. China Shenhua (1088) and Yanzhou Coal (1171) tumbled 4%-5%. Rising gold price sent Zijin Mining (2889) higher by 7%. Esprit (330) fell 11% on weakening euro. Share price of BYD Company (1211) plunged 16% due to a 25% cut in car sales target for 2010. Telecom stocks saw little change but ZTE Corporation (763) surged 16% since the India government had lifted ban on import of telecommunication equipments.

### *Growing policy risk for China and Hong Kong property developers*

Ten largest Chinese property developers, except for Longfor Properties (960), dropped an average of 9% because the PRC government had strictly implemented its tightening measures in the housing market. The Ministry of Land and Resources identified 1,457 unused plots of land for further investigation. CBRC asked commercial banks to do stress test under the assumption of a 50-60% drop in property prices. Country Garden (2007) and KWG Property (1813) raised a total of US\$650mn from the issue of senior notes. Poly HK Investment (119) raised \$3.1bn through share placement. In Hong Kong, the government also introduced new measures in mid-August aiming to stabilize the overheated residential market. However, the policy effect was partially offset by encouraging land auction results. Hong Kong property stocks therefore ended mixed. Sino Land (83) and New World Development (17) sank 8%-10% whilst Cheung Kong (1) and Hang Lung Properties (101) added 4%-7%.

## Stock Performance Summary for August 2010

Sector	Stocks	% chg in share price in Aug10	Reasons
	Hang Seng Index (20,536)	-2	Declines in U.S. and European stock markets
	HSCEI (11,402)	-4	
<b>Outperform</b>			
Miscellaneous	ZTE Corp (763)	+16	
	Hutchison (13), China Resources Enterprise (291), Tsingtao Brewery (168), Li & Fung (494)	+10 to +12	Re-rating of Hutchison after reporting interim results
<b>In line/ Mixed</b>			
Telecom	China Mobile (941), China Unicom (762)	+1 to +2	
	China Telecom (728)	-3	
HK property	Cheung Kong (1), Hang Lung Properties (101)	+4 to +7	The HKSAR introduced new measures to cool property market. Recent land auction results were better than expected.
	Swire (19), Wharf (4), Henderson Land (12)	-1 to -2	
	SHK Properties (16), Sino Land (83)	-4 to -10	
	New World Development (17)		
HK bank	BOC Hong Kong (2388)	+3	Enlarged Renminbi business in HK benefits BOC Hong Kong
	HSBC (5), Bank of East Asia (23)	-4 to -5	
Insurance	PICC P&C (2328)	+13	Re-rating of PICC P&C after reporting interim results. China Life's interim results disappointed investors.
	China Life (2628), China Pacific Insurance (2601)	-10 to -14	
China bank	ICBC (1398), CCB (939), BOC (3988), CMB (3968), BoComm (3328), CITIC Bank (998), Minsheng Bank (1988)	-2 to -5	CBRC requested banks to include loans to trust firms back to their balance sheets
Power	Huaneng (902), China Resources Power (836)	+1 to +3	
	China Longyuan (916), Datang Power (991)	-4 to -8	
Oil	CNOOC (883)	+3	Higher than expected interim earnings for CNOOC
	PetroChina (857), Sinopec (386)	-2 to -4	
Automobile	Dongfeng Motor (489)	+11	Better than expected earnings
	BYD Company (1211)	-16	Cut 2010 sales target by 25%
Airlines	Cathay Pacific (293)	+11	Higher than expected interim earnings for Cathay Pacific
	Air China (753)	-7	
Cement	Anhui Conch (914)	+2	
	CNBM (3323)	-3	
Metal	Zijin Mining (2899)	+7	Gold price hitting 2-month high is positive to Zijin Mining. Lower than expected interim earnings for Chalco.
	Jiangxi Copper (358), Angang Steel (347)	-2 to -6	
	Chalco (2600)	-10	
<b>Underperform</b>			
China property	Ten largest PRC property developers except for Longfor (960) and China Overseas Land (688)	-5 to -15	Ministry of Land & Resources found 1,457 unused plots of land for further investigation.
Shipping	China Cosco (1919), China Shipping Dev (1138)	-7 to -10	Expectation of slowing shipping demand in 4Q
Coal	China Shenhua (1088), Yanzhou Coal (1171)	-4 to -5	Expectation of slowing demand for coal in 2H10
Miscellaneous	Esprit (330), China Merchants (144)	-11	
	HKEx (388), Tencent (700), Foxconn (2038)	-5	



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