Same price, but better story

Initiating a quarterly

To communicate our latest views on a regular basis, we introduce a new publication which will highlight our latest ideas and analysis, including regular sections on macro, earnings, valuations, sentiment, and allocations and return estimates.

Flat returns on macro concerns; micro still improving

The region is flat YTD as macro issues have hurt sentiment, even as micro momentum remains supportive. In most Asian markets, valuations have declined as earnings estimates have risen or stayed stable. Investors have had time to absorb shifts in monetary and fiscal policy.

Focus: Five China issues

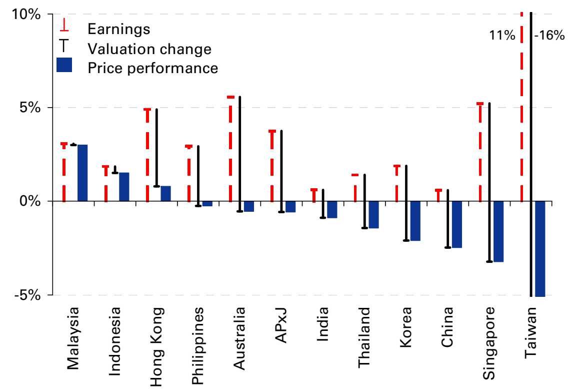
China is at the forefront of Asian macro issues, so we've chosen five areas for analysis: revaluation of the CNY, context and outlook for the banking and property sectors, our take on the National People's Congress, and the long term China consumption outlook.

Key message: Attractive risk/reward; build positions

The flat index misrepresents the improved fundamentals. We believe a risk-on period is coming, but investors need to take positions before all lights turn green. We highlight our tactical trades, risk-on recovery and CNY ideas, preferred derivative implementations, and China consumption baskets.

Valuation compression has outweighed earnings upgrades driving a pullback in Asia

Price performance decomposition into earnings and valuation changes for MSCI market indices



Source: FactSet, I/B/E/S, MSCI, GS Global ECS Research.

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The prices in the body of this report are based on the market close of March 8, 2010

The authors would like to thank Praveen B and Raymond Hung for their valuable contribution to this publication.

Bottom line

This month we are initiating a quarterly publication, in order to update clients on our views on a periodic basis (roughly mid-month, in March / June / Sept; December is our Outlook piece). Until now we have kept to a roughly quarterly schedule in terms of refreshing views and global marketing, but we feel that formalizing the process somewhat will yield dividends in terms of framework and consistency. Asia, it is often noted, grows three to four times as fast as the global economy -- therefore giving us good reason to create a forum for disseminating our latest thoughts.

Our *Asia-Pacific Kickstart*, launched in 2007, has been useful to investors wanting a condensed weekly overview of where equity markets in Asia stand; this quarterly is intended to complement the *Kickstart*'s "mostly-the-facts" style with an explanation of our up-to-date views. We hope you will find them both useful, and encourage all feedback.

Moving on to markets: In December 2009, we signaled the potential for a 2Q10 pullback because of Chinese inflation and slowing of global momentum. The market, however, had a schedule of its own - the Chinese inflation issue debuted on January 11th, and was followed in quick succession by Euro sovereign concerns (Greece, etc), and US policy and growth uncertainty. The net effect of this was a macro uncertainty-driven risk-off decline in markets, despite improving micro data.

Of the macro issues, we have taken the liberty of being highly focused on the Asia-specific issue of **China**. We examine the current situation from a variety of angles (the potential effects of CNY revaluation, contextualizing the concerns over the bank and property sectors, our take on the NPC statements), but we also try to keep the prize in sight with an overview of the long term Chinese consumption picture.

The key takeaways from our China drill-down are:

- A gradual **CNY appreciation** would have moderate benefits for China equities, but a sharper one-off appreciation (not our formal expectation, but a credible possibility) would likely spark a broad-based 'risk-on' regional equity rally.
- There are areas of concern for the China **banks** (rapid rise in exposure to local infrastructure projects) and China's **real estate** market (notably commercial property). However, the size of the exposures and other objective fundamental measures suggest these are manageable challenges and are not likely to pose systemic risks unless the economy enters a severe downturn.
- China's policy makers have reaffirmed their pro-growth orientation at the **National People's Congress**; we believe the risk of excessive policy tightening is low.

Two and a half months into the year, Asian markets have gyrated considerably but the regional index is essentially unchanged. What is different is that earnings continue to rise and valuations have fallen. Furthermore, investors have had a chance to absorb and at least partly discount the shift in monetary and fiscal policy as Asia's growth recovery continues. Thus, **we view the risk/reward balance very positively from a strategic perspective** and reaffirm our overweight stance on China, Korea and Taiwan.

Overall, it is our strong sense that investors agree markets are attractively valued, but hesitate to radically increase exposure without Chinese inflation/tightening issues and Greek debt concerns fading into the background. Although we cannot say precisely how these issues will play out, we believe that sentiment and valuation will improve as the year progresses, and we would prefer to be early – it is our contention that **by the time all the lights turn green, the race will already be well underway**.

The structure (and summary) of the piece is as follows:

- **Spotlight on China:**
  - What if the CNY is revalued?
  - Why we like Chinese banks
  - China property: Valid but largely manageable concerns
  - The National People's Congress: Pro-growth bias remains
  - Picking the Chinese consumption winners

- **Taiwan and Korea:** Brief updates on our positive stance.
- **Performance:** The first quarter has been uniformly characterized by a risk-off macro mindset despite small improvements in micro estimates.
- **Macro:** Our economists continue to expect strong regional growth; the dominant macro theme will remain normalization of policy from very accommodative fiscal and monetary settings.
- **Earnings**: We have adjusted our estimates for a higher 2009 base and look for 30% growth in 2010 and about 21% in 2011. Consensus estimates for 2010 have risen to 26% growth and are now only 4% away from our numbers compared to 11% in December.
- **Valuation**: Regional valuations have compressed: the forward P/E is 13.2x and trailing price/book ratio is 2.0x. We now feel there is less debate about earnings and that valuations and investor sentiment will be the primary battleground to determine market performance.
- **Sentiment/risk appetite**: We believe investors remain fairly cautiously positioned, but are inclined to become more positive.
- **Returns/allocations**: Based on our updated earnings forecasts, we modify our year-end targets but do not change any of our preferences - we still expect the greatest upside in China, Korea, and Taiwan. Our targets equate to a 27% potential regional price return and 32% total USD return, and would imply valuations of 14.0x forward P/E and 2.3x trailing book. These are moderate in absolute terms and relative to the region's valuation range.
- **Implementation:** We summarize our current Asia Trading Views, CNY ideas, derivative implementation strategies, China consumption baskets, and recovery stock ideas.

Exhibit 1: We expect 32-36% USD total returns for 2010, and are overweight China, Korea and Taiwan

	Market	Index	Current index level	Dec-10 target: Price target	Dec-10 target: Local FX Price return (%)	Total return: Dividend yield (%)	Total return: 12M GS FX rates (%)	Total return: Dec-10 Total return (%)
Overweight	China	HSCEI	12,203	17,000	39	3	0	42
	Korea	KOSPI	1,660	2,300	39	2	5	45
	Taiwan	TWSE	7,762	10,900	40	4	6	51
Market weight	India	SENSEX	16,994	20,000	18	1	8	27
	Hong Kong	MXHK	10,260	11,700	14	3	(1)	16
	Indonesia	JCI	2,626	3,000	14	3	6	23
Underweight	Australia	AS51	4,808	5,700	19	4	(1)	22
	Singapore	FSSTI	2,835	3,200	13	3	3	19
	Philippines	PCOMP	3,095	3,600	16	3	6	25
	Malaysia	FBMKLCI	1,324	1,500	13	3	4	21
	Thailand	SET	720	840	17	4	1	22
Asia Pacific ex Japan (USD)		MXAPJ	414	530	27	3	2	32
Asia ex Japan (USD)		MXASJ	480	640	30	3	3	36

Source: GS Global ECS Research estimates.

Exhibit 2: We favor tech sectors and China banks

GS "true sector" preference

Overweight	Marketweight	Underweight
Semi & Hardware	Transportation	Australia Property
China Banks	Hong Kong Property	Chemicals
Energy	India Financials	India Utilities
Steel	Hong Kong Banks	Singapore Property
China Insurance	India IT Services	China Telecom
Korea Financials	Singapore Banks	
	China Property	
	Mining	
	Korea Autos	
	Capital Goods	
	Taiwan Financials	
	Australia Banks	

Note: We defined a framework of Asian "true sectors" based on coherence and tradability. Please refer to our report: Asia Pacific: Portfolio Strategy: Asia Sector Radar: Mapping the terrain, June 1, 2009. These sectors account for close to 80% of regional market cap.

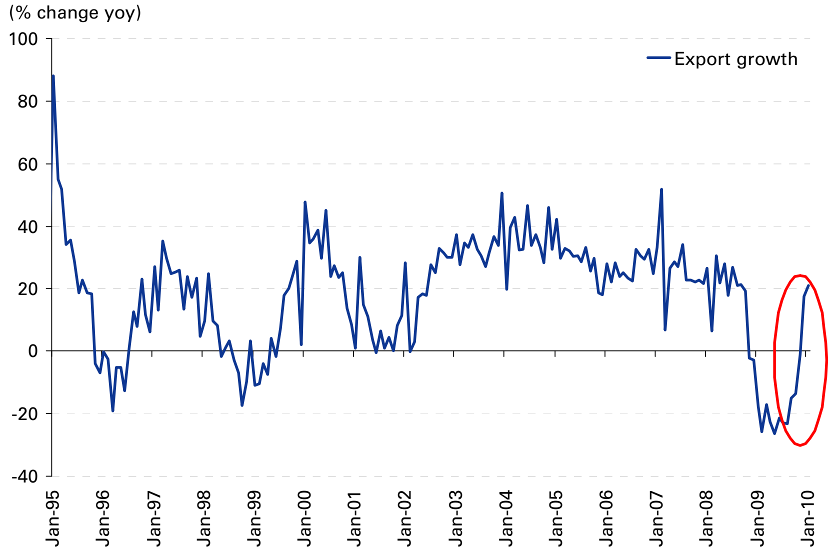
Source: GS Global ECS Research.

Focus issue 1: Potential CNY appreciation

Investors have asked us about the potential impact of a renminbi revaluation, and in the report we published previously (*Asia Pacific: Portfolio Strategy: What if the CNY appreciates?*, March 3), we looked into the following areas:

- Our economists' forecast calls for a **5% appreciation versus the USD** during 2H2010, but there is a possibility for an earlier move. Reasons the market is focused on this issue include the export recovery, currency adjustment as an inflation tool, and movement in the CNY NDF. We study the potential impact for both a gradual and one-off appreciation.
- We analyzed the **performance of various asset classes** during the period immediately following the 2% surprise revaluation announcement on 21 July 2005, and in general risk assets performed well. Asian spot currencies staged a broad 1-2% move, but there was not much persistence in the ensuing 1-3 months. FX forwards did not move much. Regional equities rose 2% on the July 21-22, with China onshore and offshore stocks up 8-11% after 1 month. Energy and materials were the sectors that moved earliest, after which the rally broadened. Oil, copper and cotton were the stronger immediate commodity movers (Exhibit 6).
- **Gradual appreciation:** In this scenario, we feel China equities would benefit to a moderate extent from **translation gains, operational benefits, and lower risk premia**; we feel there would be **limited effects on regional markets**.
- **"One off" could translate into "risk-on":** Currently, the central issue for China and regional investors is how China will control the inflation / growth tradeoff. We feel a one-off CNY appreciation would signal both government confidence in the macro environment – including the external sector – and willingness to use market measures to contain inflation. We think this "risk-on" dimension would outweigh currency effects for equity markets, and a broader, more substantial equity rally might result.
- **Implementation:** We highlight (1) stocks that benefit from FX-specific channels for a gradual appreciation, (2) a portfolio of depressed cyclicals to benefit from a "risk-on" trade under a one-off revaluation scenario, and (3) Japan China-exposed stocks who have meaningful business exposure to China (Exhibit 8-10).

Exhibit 3: Exports are recovering and domestic demand is strong, indicating conditions are more favorable for currency appreciation
Export (left) and domestic demand growth (right)



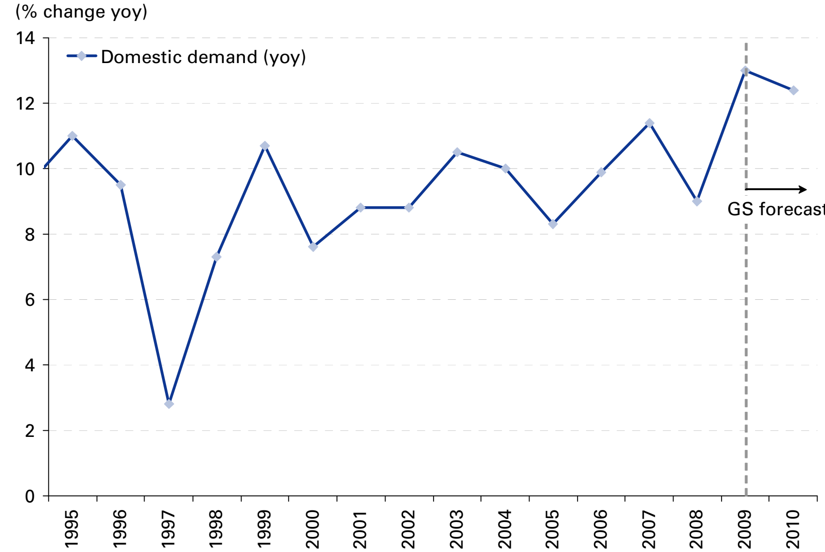


Exhibit 4: CNY NDF points have recently strengthened
Time series of CNY 6M NDF

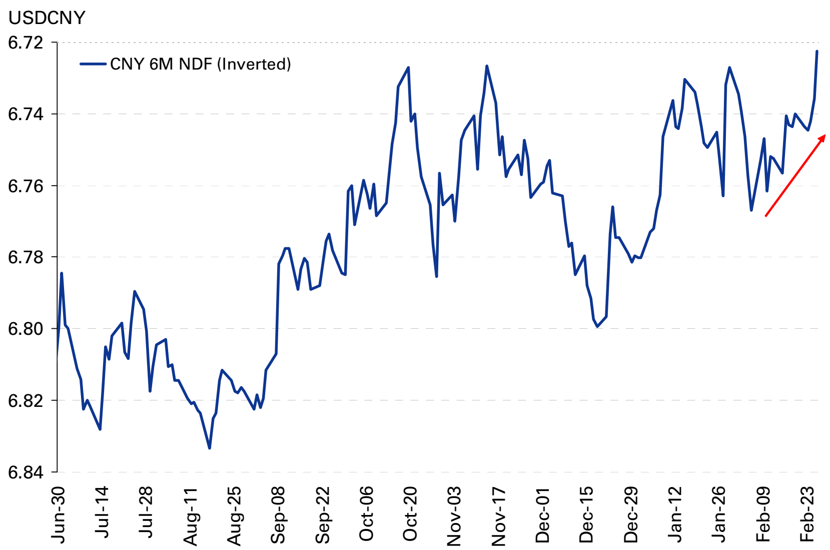
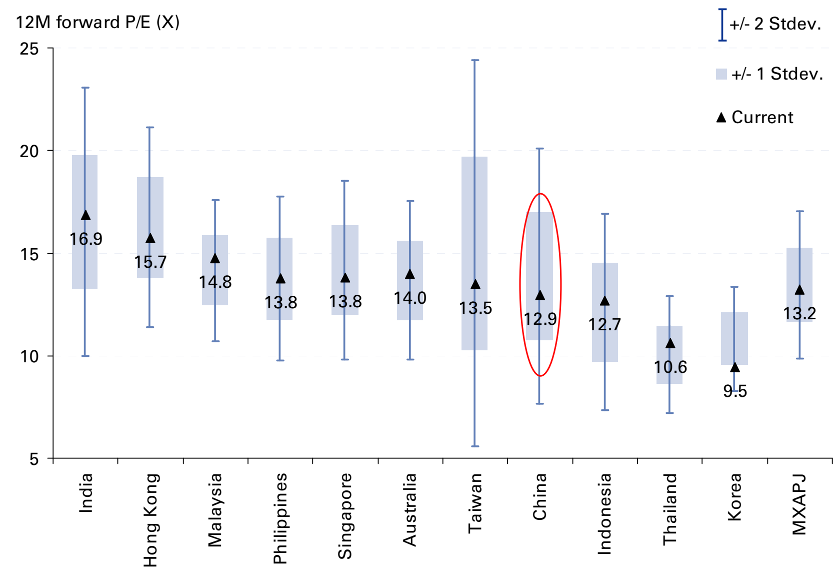


Exhibit 5: Despite its improving fundamentals, China is one of the few markets in Asia trading below its 5-year average P/E
12M forward P/E relative to historical range



Source: CEIC, Bloomberg, FactSet, I/B/E/S, MSCI, GS Global ECS Research estimates.

Exhibit 6: Cyclical assets in Asia generally outperformed when the CNY revalued

Performance of different asset classes around 2% CNY revaluation (announcement was made after HK close on Jul 21, 2005)

	Performance post CNY revaluation (%)				
	21-Jul-05	22-Jul-05	1-week	1-month	3-month
MSCI Regional Equity Indices					
CSI 300	0.2	1.8	6.1	10.6	6.8
China	1.7	0.9	3.6	8.3	1.4
Australia	1.0	0.6	1.9	4.8	2.3
Hong Kong	-0.4	1.3	0.8	1.4	-3.6
India	-0.6	1.5	3.2	4.3	6.4
Indonesia	1.9	1.9	3.8	-6.2	-8.3
Japan	-0.2	-0.6	0.0	6.3	16.8
Korea	0.2	-0.6	1.0	3.9	6.7
Malaysia	-0.2	1.9	1.0	-0.5	-1.4
Philippines	0.6	-0.7	0.5	0.6	-0.1
Singapore Free	0.1	0.5	1.0	-0.9	-4.5
Taiwan	-0.2	-0.5	-2.1	-3.9	-11.0
Thailand	-0.3	0.0	2.7	7.3	3.0
MXAPJ	1.1	1.0	1.5	2.9	-1.3

	Performance post CNY revaluation (%)				
	21-Jul-05	22-Jul-05	1-week	1-month	3-month
MSCI China Sectors					
Energy	4.5	0.2	9.2	11.2	0.4
Materials	3.7	-0.9	0.6	5.0	4.4
Industrials	0.9	0.5	0.6	2.6	-7.2
Consumer Disc.	0.8	2.3	2.4	2.6	16.8
Consumer Staples	1.9	0.5	0.5	-4.3	-3.6
Health Care	--	--	--	--	--
Financials	0.1	1.4	1.1	11.4	7.3
Info Tech	-0.9	-2.9	-1.7	2.1	-2.6
Telecom Services	0.3	2.1	2.4	13.7	10.2
Utilities	0.4	2.1	2.9	1.9	-1.6

	Performance post CNY revaluation (%)				
	21-Jul-05	22-Jul-05	1-week	1-month	3-month
MSCI AC Asia Pacific ex Japan Sectors					
Energy	2.4	0.4	4.8	7.6	1.7
Materials	2.3	1.0	1.7	7.4	2.5
Industrials	1.1	0.6	1.3	4.0	-2.8
Consumer Disc.	0.8	0.8	1.8	2.7	-0.2
Consumer Staples	1.0	1.5	1.1	2.7	0.5
Health Care	2.0	0.8	2.6	4.1	2.2
Financials	0.8	1.5	1.9	2.2	0.1
Info Tech	0.8	-0.1	-1.3	-1.4	-8.3
Telecom Services	1.0	2.0	2.9	3.5	-2.1
Utilities	0.8	1.7	2.1	2.3	0.9

	Performance post CNY revaluation (%)				
	21-Jul-05	22-Jul-05	1-week	1-month	3-month
Asian currencies vs. USD (Spot, Asian Trading Hours)					
CNY	0.0	2.1	2.1	2.1	2.3
AUD	1.0	0.9	0.5	0.2	-0.3
HKD	0.0	0.1	0.0	0.1	0.3
IDR	0.6	0.1	0.2	-1.7	-2.6
INR	0.1	0.3	0.0	-0.1	-3.6
JPY	0.4	1.6	0.4	2.8	-2.2
KRW	0.6	1.4	1.1	1.9	-1.3
MYR	0.0	0.5	1.3	0.8	0.7
PHP	0.0	0.5	-0.4	0.1	0.3
SGD	0.5	1.3	1.3	1.4	-0.3
THB	0.3	1.2	0.7	2.2	2.7
TWD	0.1	1.1	0.1	-0.4	-5.0

	Performance post CNY revaluation (%)				
	21-Jul-05	22-Jul-05	1-week	1-month	3-month
Asian currencies vs. USD (1y Forward, Asian Trading Hours)					
CNY	0.0	0.8	0.6	-0.5	-0.3
AUD	1.0	0.9	0.6	0.5	0.1
HKD	0.0	0.2	0.0	-0.1	0.0
IDR	0.5	0.0	0.0	-3.1	-5.3
INR	0.2	0.6	0.6	0.4	-3.7
JPY	0.4	1.6	0.5	2.9	-1.9
KRW	0.7	1.5	1.1	2.1	-1.3
MYR	0.0	0.7	1.3	0.3	-0.5
PHP	-0.1	0.9	-0.4	0.0	-0.2
SGD	0.5	1.4	1.3	1.5	-0.2
THB	0.3	1.2	0.7	2.1	2.1
TWD	0.2	1.2	0.1	-0.5	-5.2

	Performance post CNY revaluation (%)				
	21-Jul-05	22-Jul-05	1-week	1-month	3-month
Commodities (Near-by Contracts)					
Shanghai Coal	-0.4	0.0	0.9	-1.3	1.8
Shanghai Aluminu	0.1	-0.1	-0.2	-0.4	4.0
Shanghai Copper	0.2	-0.2	3.4	1.7	10.9
NYMEX WTI	0.7	2.7	4.2	15.4	7.6
CMX Gold	0.9	-0.2	0.6	3.8	9.2
LME Copper	-0.1	1.6	2.9	6.0	15.2
LME Aluminum	-0.9	0.9	0.6	4.9	8.3
NYB Cotton	1.3	2.7	3.7	-2.0	10.3

<< 1+ std dev based on 3m realized vol on Jul 20, 2005

<< 2+ std dev based on 3m realized vol on Jul 20, 2005

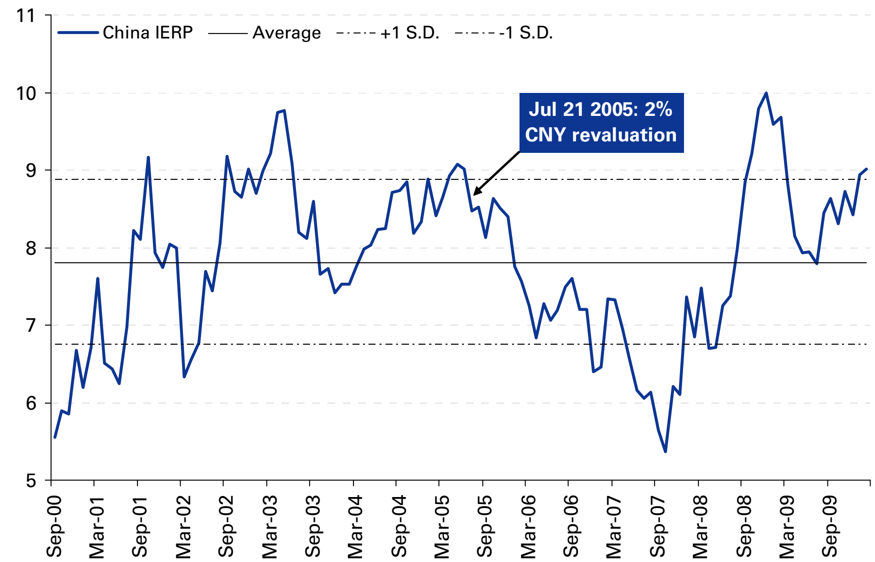
Note: 1-week, 1-month and 3-month figures are cumulative performance based off July 20, 2005 closing. 21 Jul 05 and 22 Jul 05 is 1-day performance on the date.

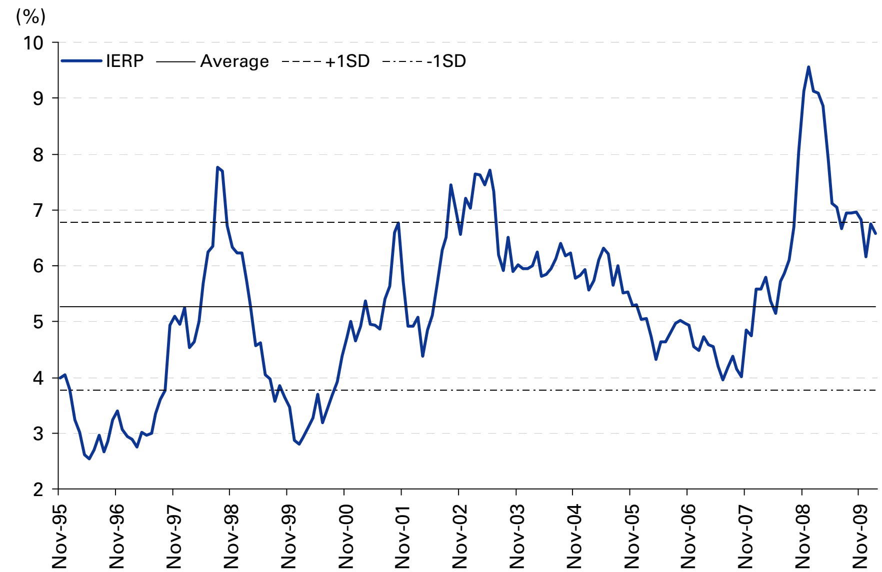
We have not highlighted boxes where the performance represents more than a 1 standard deviation move, but was unlikely to have been related to the change in the CNY. For example, a -4.5% move in the Singapore Free index in 3M is unlikely to have been related to the CNY move, especially since it moved the opposite direction on the day of revaluation.

Source: Bloomberg, GS Global ECS Research.

Exhibit 7: Improved confidence in China's economy, possibly linked to a CNY reval, could increase risk appetite: both the China offshore and regional implied equity risk premia (IERP) are currently 1 SD above the mean; a return to mean would equate to roughly 30% upside for both

IERP series of MSCI China index (left) and MSCI AC Asia Pacific ex Japan index (right)





Source: FactSet, I/B/E/S, MSCI, GS Global ECS Research estimates

Exhibit 8: China stocks with greater CNY sensitivity

Bloomberg	Name	% chg in 10E NI on 1% Rmb appr.	Listed cap (US$mn)	Rating	Pricing currency	Price (Mar 08)	Upside/ downside to TP	Ytd perf	EPS gwth 2010E	EPS gwth 2011E	ROE 2010E	ROE 2011E	P/E 2010E	P/E 2011E	P/B 2010E	Div yld 2010E
1055 HK	China Southern Airlines (H)	**16.8%**	2,520	Buy	HKD	3.0	11	-19	NM	17	17	16	8.3	7.1	1.5	0.0
386 HK	Sinopec (H)	**7.2%**	69,845	Neutral	HKD	6	2	0	1	15	15	16	7.3	6.3	1.2	3.3
753 HK	Air China (H)	**6.4%**	10,691	Neutral	HKD	6.8	-17	-12	9	63	12	17	22.3	13.7	2.6	0.3
297 HK	Sinofert	**5.2%**	4,471	Neutral	HKD	5	-15	-21	NM	51	8	11	29.5	19.5	2.4	0.5
323 HK	Maanshan Iron & Steel (H)	**5.2%**	4,923	Neutral	HKD	5.0	7	-6	500	6	9	8	12.0	11.4	1.2	2.2
600005 CH	Wuhan Iron & Steel	**2.7%**	7,762	Neutral	CNY	6.8	12	0	206	2	17	15	10.8	10.6	1.7	4.5
347 HK	Angang Steel (H)	**2.4%**	13,932	Neutral	HKD	15	0	-6	362	16	10	11	16.7	14.3	1.6	0.7
606 HK	China Agri-Ind	**2.3%**	5,330	Buy	HKD	10.7	18	-20	26	14	15	15	13.6	11.9	2.3	1.5
600019 CH	Baoshan Iron & Steel	**2.0%**	21,574	Neutral	CNY	8	7	0	81	6	9	9	14.1	13.3	1.4	3.5
992 HK	Lenovo	**1.6%**	6,399	Buy	HKD	5.4	21	-19	689	32	22	23	17.0	12.9	3.6	0.3

For important disclosures, please go to http://www.gs.com/research/hedge.html

Source: Bloomberg, Goldman Sachs Research estimates.

Exhibit 9: "Risk-on" ideas in the event of a one-off CNY revaluation

Bloomberg	Name	Listed cap (US$mn)	Rating	Pricing currency	Price (Mar 08)	Upside/ downside to TP	Ytd perf	EPS gwth 2010E	EPS gwth 2011E	ROE 2010E	ROE 2011E	P/E 2010E	P/E 2011E	P/B 2010E	Div yld 2010E
China market															
939 HK	China Constr Bank (H)	**187,049**	Buy*	HKD	6.2	26	-1	33	26	24	27	8.8	7.0	2.1	5.6
1088 HK	China Shenhua Energy (H)	**89,856**	Buy	HKD	35	43	-7	46	13	21	20	12.5	11.1	3.0	2.7
883 HK	CNOOC	**72,701**	Buy*	HKD	12.6	24	-8	76	13	28	27	9.0	7.9	2.3	4.3
2318 HK	Ping An Insurance (H)	**58,554**	Buy	HKD	62	27	-4	26	25	15	16	23.6	19.0	3.5	1.5
998 HK	China Citic Bank (H)	**29,281**	Buy	HKD	5.8	17	-2	33	25	18	20	9.8	7.8	1.7	3.1
1898 HK	China Coal Energy (H)	**22,114**	Buy	HKD	12.9	47	-11	71	22	17	18	11.4	9.3	2.0	2.5
267 HK	Citic Pacific	**8,403**	Buy*	HKD	17.9	55	-3	-3	46	7	10	14.0	9.6	1.1	1.7
813 HK	Shimao Prop	**5,959**	Buy	HKD	14	16	0	-6	23	15	16	11.6	9.4	1.6	0.9
2319 HK	China Mengniu Dairy	**4,595**	Buy*	HKD	25	18	0	31	27	18	19	22.0	17.4	3.9	1.1
3818 HK	China Dongxiang	**4,006**	Buy*	HKD	5.5	31	-1	22	22	22	23	15.2	12.5	3.2	2.6
Other regional markets															
005930 KS	Samsung Elec	**117,982**	Neutral	KRW	786,000	18	-6	33	3	18	16	10.4	10.1	1.7	1.0
005490 KS	POSCO	**43,341**	Buy*	KRW	563,000	25	-1	34	2	12	11	12.5	12.3	1.4	1.4
2317 TT	Hon Hai Precision Ind	**36,930**	Buy	TWD	137.5	27	-1	30	17	16	16	13.4	11.4	2.2	2.1
WIL SP	Wilmar Intl	**30,966**	Buy	SGD	6.8	27	-10	18	25	16	18	15.8	12.7	2.5	2.0
388 HK	Hong Kong Exchanges	**18,518**	Buy	HKD	133.5	17	-8	20	24	66	71	25.5	20.6	15.7	3.5
2454 TT	MediaTek	**17,693**	Buy	TWD	528.0	11	-5	13	16	35	36	13.7	11.8	4.6	5.1
101 HK	Hang Lung Prop	**16,564**	Buy*	HKD	31.0	12	-4	22	3	9	9	19.1	18.6	1.7	2.3
066570 KS	LG Elec	**15,091**	Buy*	KRW	105,500	30	-4	16	13	13	12	7.1	6.3	1.4	1.7
293 HK	Cathay Pacific Airways	**7,370**	Buy	HKD	14.5	13	0	19	132	6	13	23.6	10.2	1.3	2.1
683 HK	Kerry Prop	**7,239**	Buy	HKD	39.4	27	-3	27	16	6	6	17.3	14.9	1.1	1.9

* On our Regional Conviction List

Exhibit 10: Valuation summary for constituents of our GS Japan China-exposed (GSSZJPCN) CAT basket

Bloomberg	Name	Listed cap (US$mn)	Rating	Pricing currency	Price (Mar 08)	Upside/ downside to TP	Ytd perf	EPS gwth 2010E	EPS gwth 2011E	ROE 2010E	ROE 2011E	P/E 2010E	P/E 2011E	P/B 2010E	Div yld 2010E
8058 JP	Mitsubishi	**44,018**	Neutral	JPY	2346	15	-9	22	13	10	11	11.4	10.1	1.3	2.0
8031 JP	Mitsui	**30,466**	Buy	JPY	1509	13	-13	54	23	9	10	12.0	9.8	1.2	1.7
5401 JP	Nippon Steel	**24,402**	Buy	JPY	350	40	-5	300	42	7	9	15.1	10.6	1.2	1.8
5411 JP	JFE	**22,952**	Buy*	JPY	3570	62	-3	181	34	13	16	10.0	7.4	1.3	2.0
6954 JP	Fanuc	**20,496**	Neutral	JPY	9180	9	-7	17	37	7	9	31.4	22.9	2.3	1.0
6301 JP	Komatsu	**20,333**	Buy	JPY	1899	16	-8	70	65	9	13	23.8	14.5	2.1	1.0
6367 JP	Daikin Ind	**11,614**	Buy	JPY	3595	17	-2	72	72	7	11	28.2	16.4	2.0	0.9
8002 JP	Marubeni	**10,767**	Buy	JPY	560	10	-9	26	20	14	15	8.1	6.7	1.1	2.0
4911 JP	Shiseido	**9,094**	Not Rated	JPY	2005	NA	-13	20	13	9	10	25.6	22.7	2.4	2.5
9104 JP	Mitsui OSK Lines	**8,154**	Buy	JPY	616	19	-22	41	68	8	12	13.7	8.1	1.1	1.5
8267 JP	Aeon (JP)	**8,125**	Buy	JPY	932	23	-20	NA	36	3	4	22.2	16.3	0.8	1.8
6305 JP	Hitachi Constr Machinery	**4,770**	Neutral	JPY	2090	3	-6	149	101	5	8	26.9	13.3	1.4	0.7
9101 JP	Nippon Yusen	**4,714**	Neutral	JPY	347	21	-19	NA	148	2	5	41.8	16.8	0.9	1.1
7003 JP	Mitsui Engg & Shipbuilding	**2,008**	Neutral	JPY	219	14	-9	32	17	12	13	8.1	7.0	1.1	3.2
4042 JP	Tosoh	**1,483**	Sell*	JPY	224	-20	-4	NM	NM	-5	1	NA	65.1	1.0	1.7

Note: The ability to trade this basket will depend upon market conditions, including liquidity and borrow constraints at the time of trade.
* On our Regional Conviction List

Source: Bloomberg, Goldman Sachs Research estimates.

Focus issue 2—China banks: Concerns well priced in; add on attractive risk/reward

We have turned positive on Chinese banks as we think key macro concerns appear well priced in, earnings fundamentals remain intact, and the low valuations and light investor positioning imply limited downside risk. We have initiated a long position in our China banks basket (GSCNBANK) to implement our positive view on Chinese banks (please see *Asia Pacific: Portfolio Strategy: Opening trades on China banks (GSCNBANK) and JFE Holdings*, March 5)

- **Significant underperformance/ attractive valuation:** China banks have declined nearly 20% since their mid-November highs, and valuations are attractive relative to history and to other major sectors in China and the region. Even if we factor in more severe infrastructure NPLs than our base case as well as dilution from capital raising, the sector's P/Es are still low in absolute and relative terms.
- **Capital raising is "half way" done**: After announcement of recap plans for BOC, BoCom and CMB, we believe about half of China H-share banks' overall recap announcements (i.e. number of banks, not recap amount) have been made (Exhibit 11). Given H-share banks' low leverage-adjusted P/E of 11X 2010E P/E and 9X 2011E P/E and the progressively less negative share price responses to the recap announcements by BOC, BoCom and CMB, it appears that the market has priced in cap raising concerns to a large extent (Exhibit 12).
- **NPL risks appear well discounted in the price:** Investors are increasingly concerned about the NPL risks relating to loans to local infrastructure projects. Our analyst estimates that these loans could equate to Rmb4.0 to 4.8 tn (around 10% of total loans and 13% of 2009 GDP) (Exhibit 13). Based on a harsh case scenario in our analyst's sensitivity analysis, in which he assumes 50% NPL ratios for these loans and amortizing credit losses over five years, H-share banks (excl. CMB) would trade at reasonable adjusted P/Es of 13X 2010E and 10X 2011E (Exhibit 14). We view this scenario as unlikely given that corporates' financial health has improved significantly as shown by the sharp rebound in EBIT interest coverage (Exhibit 15).
- **Systemic risks remain low for the banking sector**: From a macro view, systemic risks for the Chinese banking sector seem low. First, China has been running counter-cyclical credit policy over the past few years as suggested by the excess credit growth trend (Exhibit 16). Second, China's total debt to GDP is still meaningfully lower than many developed markets while China's economy is growing at a much faster pace (Exhibit 17). Third, China is in a better fiscal position now versus during the Asian financial crisis and this suggests that China can better cope with a potential resurgence of financial adversity (Exhibit 18).
- **Market-based tightening measures are fundamentally positive for banks:** We still believe that timely and prudent counter-cyclical tightening measures could smooth out growth volatility and prolong the economic cycle. Specifically, in the context of rising inflationary pressure in China, inflation-fighting policy tools including required reserve ratio (RRR) and benchmark interest rate hikes are positive to banks' net interest margin (NIM) (Exhibit 19) and currency appreciation could benefit banks equity through the channels of translation gains and potentially lower equity premium (higher policy flexibility) .
- **Favorable investor positioning**: China banks are the largest sector in the offshore China indices (currently 22% in MXCN, 48% in HSCEI) and the second largest country-sector in the MSCI Asia ex Japan index (6% of MXASJ). Thus, the sector "call" is important to investors who are judged against index benchmarks. We feel that improving price momentum will impel many investors to re-engage, given our belief that institutional investor exposure to the sector is low at present.

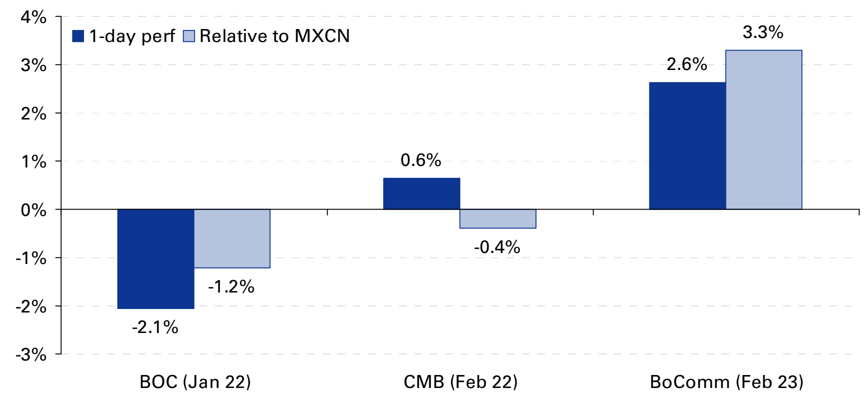
Exhibit 11: Half of the H-share listed banks have already announced capital raising plans

Our estimated and actual cap raising amount for Chinese banks

Company	2010E Basel 3 Tier 1 CAR	Required Tier 1 CAR	2010E RWA (Rmb Bn)	Capital shortfall (Rmb Bn)	Announced tier 1 capital raising (Rmb Bn)	Additional capital needed (Rmb Bn)	Total capital raising under our scenario (Rmb Bn)
ICBC	8.8%	9.0%	6,960,395	12,778		12,778	12,778
BOC	7.1%	9.0%	6,209,925	120,250	40,000	80,250	120,250
CCB	7.8%	9.0%	6,241,251	72,547		72,547	72,547
BoCom	7.5%	9.0%	2,150,803	32,360	42,000	-	42,000
CMB	6.4%	8.0%	1,427,612	23,136	22,000	1,136	23,136
CNCB	8.3%	8.0%	1,307,974	-		-	-
Minsheng	7.6%	8.0%	1,295,481	5,706	27,451	-	-
Total				266,777	89,451	199,071	261,071

Exhibit 12: Market reactions to recap announcements are increasingly positive, implying recap risk is well-priced

Relative performance pre- and post- recap announcements



Note: BOC and BoComm's announcements are the proposal of capital raising, CMB's is about the details following up its previous plan announced (in 2009). 1-day performance is the price change of the next day, as announcements are made after market close.

Exhibit 13: Rapid loan growth for infrastructure projects is a source of concern; new policy measures to ringfence the potential risks are being implemented

New loans breakdown

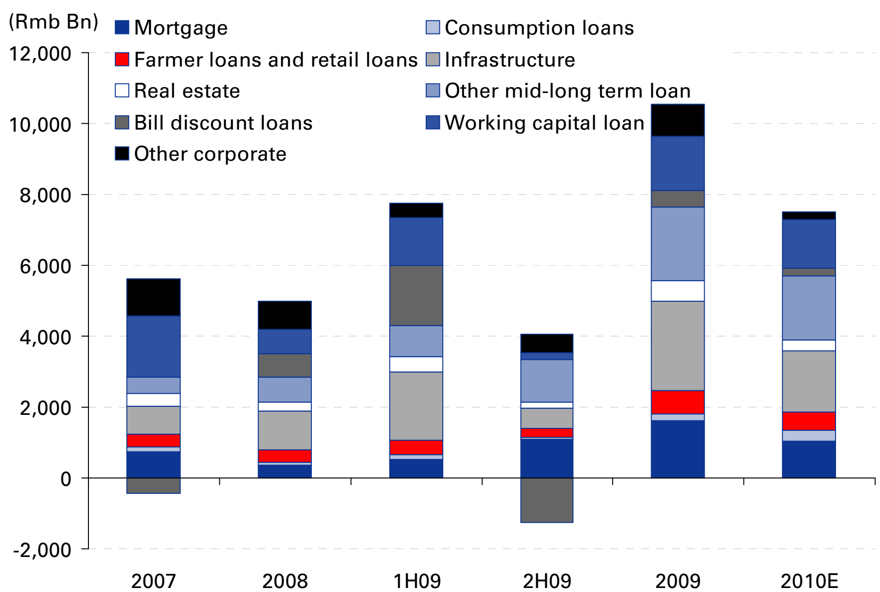
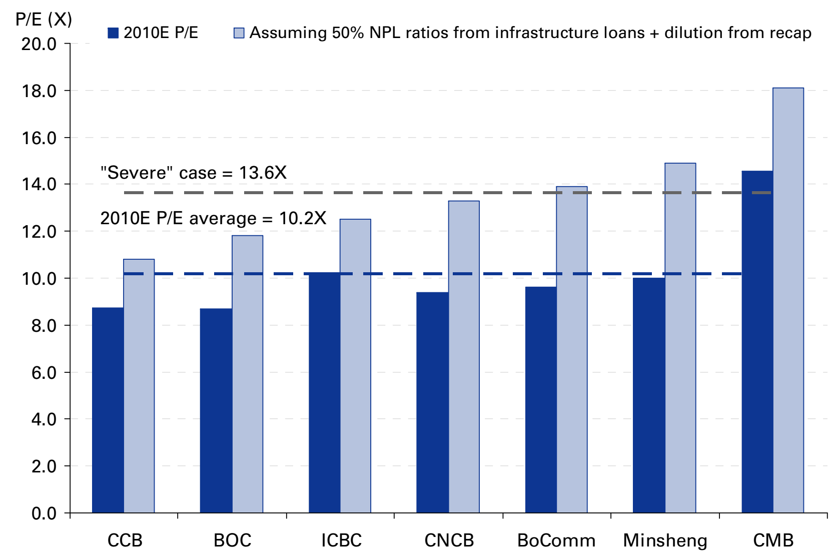


Exhibit 14: China banks' P/Es would still be attractive even if we factor in more severe infrastructure NPLs and the earnings dilution from capital raising

P/E multiples of H shares banks



Source: Bloomberg, Company data, Goldman Sachs Research estimates.

Exhibit 15: Corporate financials health has improved; systemic financial risk is low with 4x EBIT interest cover
EBIT interest cover

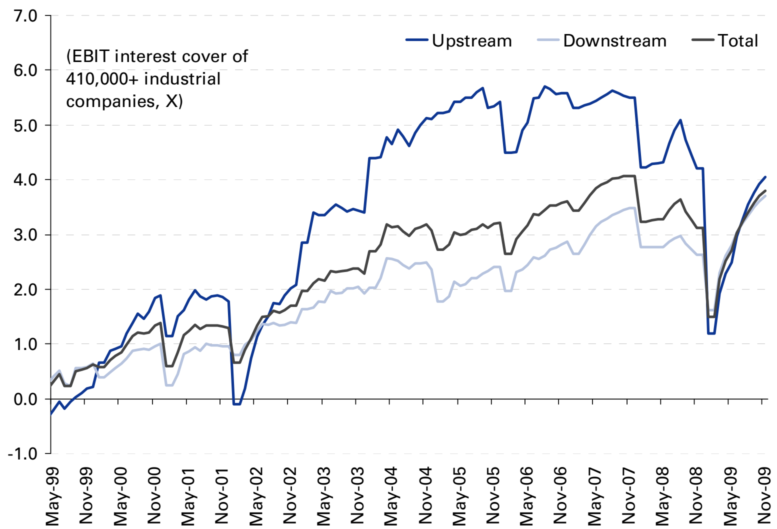


Exhibit 16: China ran a tight countercyclical monetary policy prior to the 2009 credit surge
Excess credit growth trend

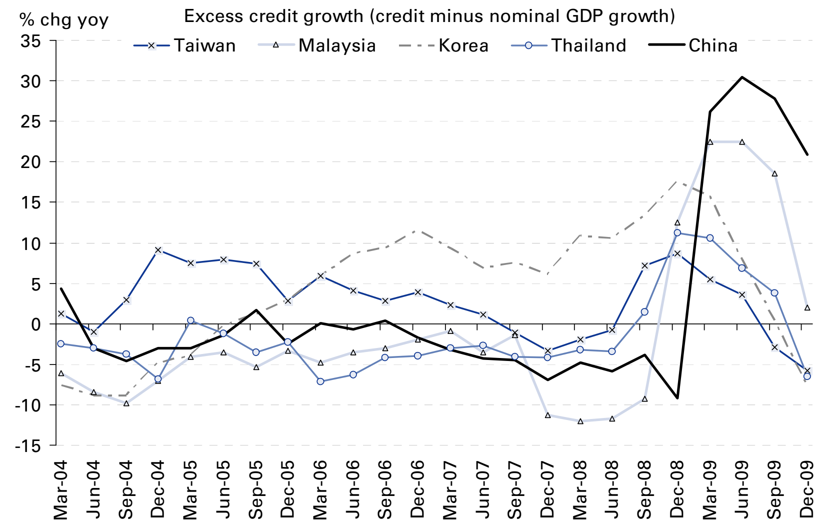


Exhibit 17: China's total leverage is not high in a regional context
Total debt to GDP

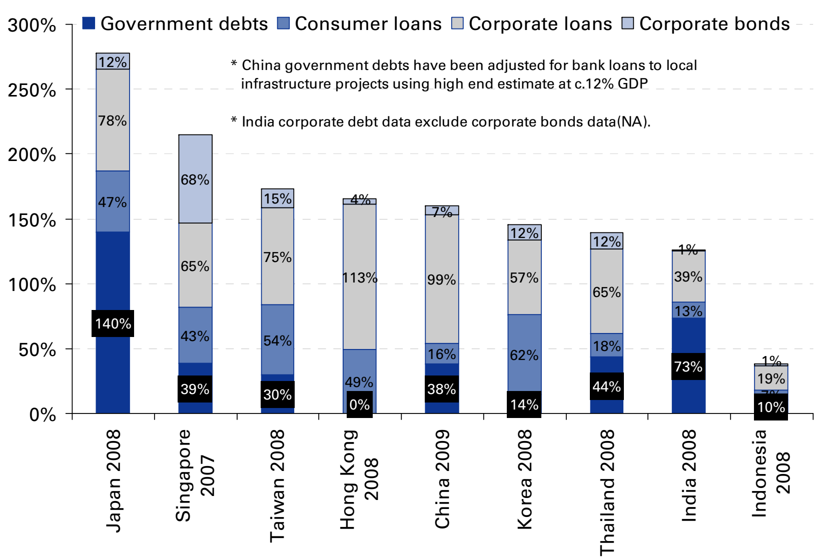
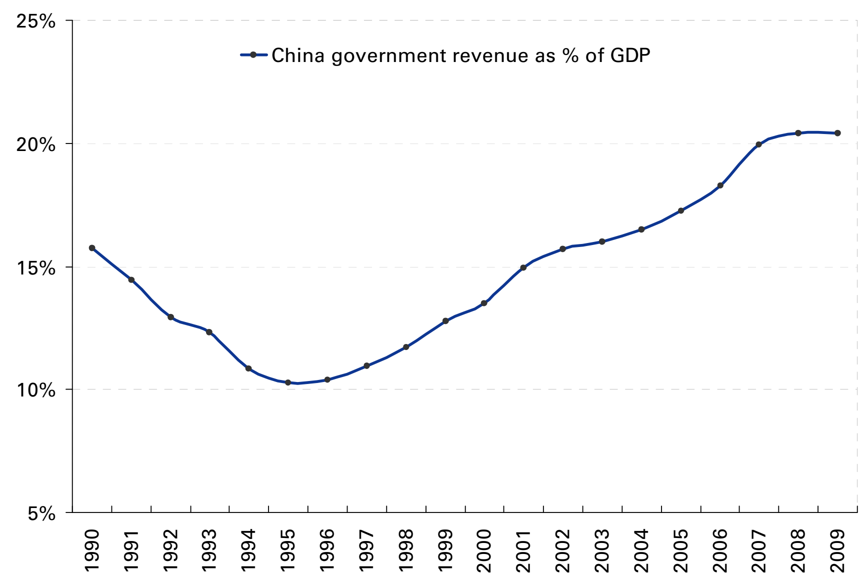


Exhibit 18: China is now in a better fiscal position than during the Asian financial crisis
Fiscal revenue as % of GDP



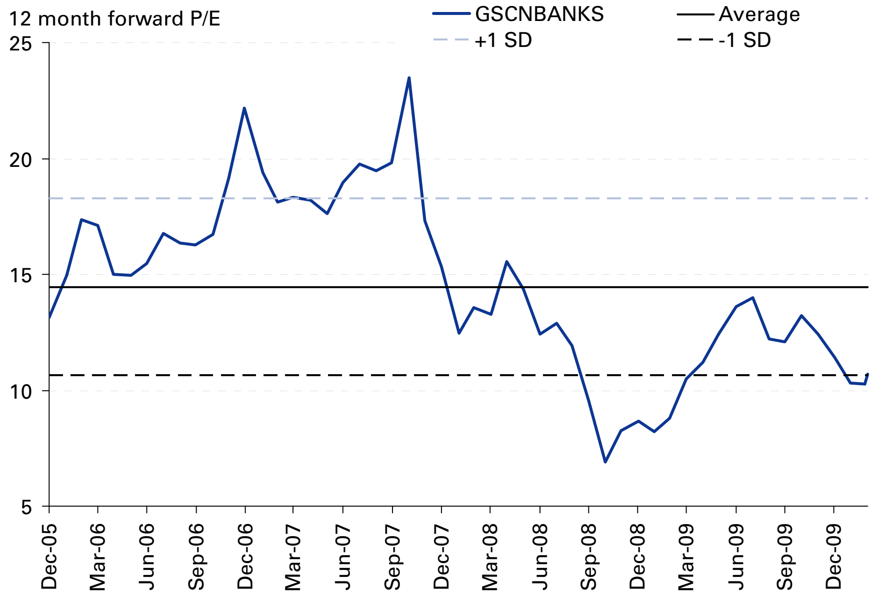
Source: CEIC, Company data, Goldman Sachs Research estimates.

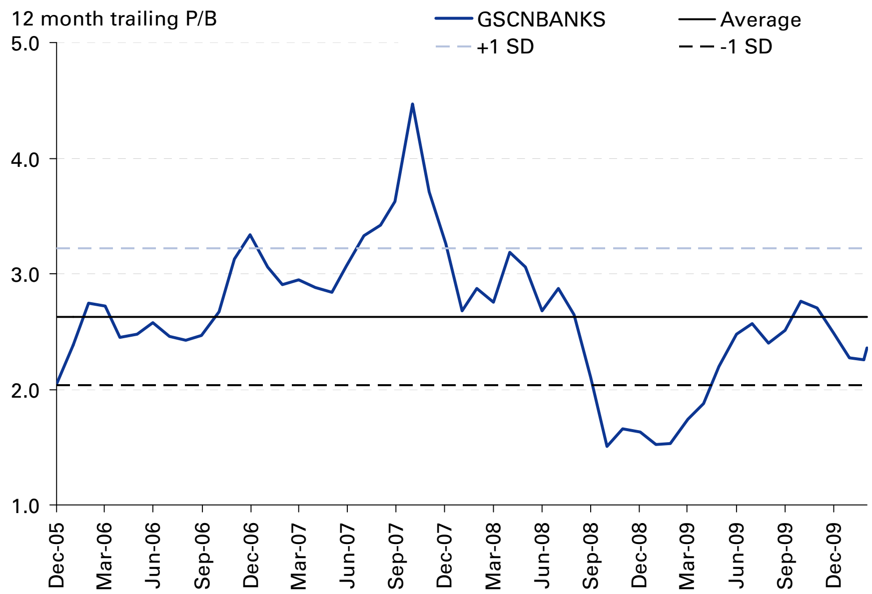
Exhibit 19: Monetary tightening measures could be positive for banks' margins
Earnings sensitivity with regard to RRR, and interest hike

	NIM change due to rate hike		NIM change due to 0.5% RRR hike	
Company	Total rate hike impact (bp)	Equivalent impacts on 2010E NPAT	Total RRR hike impact (bp)	Equivalent impacts on 2010E NPAT
ICBC	8.0	4.5%	4.2	2.4%
BOC	4.2	2.3%	1.6	0.9%
CCB	10.0	6.7%	4.3	2.9%
BoCom	7.4	5.6%	3.1	2.3%
CMB	8.7	6.4%	3.2	2.3%
CNCB	9.6	6.2%	1.4	0.9%
Minsheng	8.3	6.9%	3.0	2.5%
Average	**8.3**	**5.9%**	**2.8**	**2.1%**

Source: Company data, Goldman Sachs Research estimates.

Exhibit 20: China banks' valuations are inexpensive in absolute terms and relative to their range
Historical forward P/E (left) and trailing P/B series





Source: Company data, FactSet, I/B/E/S, Goldman Sachs Research estimates.

Focus issue 3—China property: Valid but largely manageable concerns

Many investors and market commentators have recently expressed concerns regarding a Chinese property market bubble, especially in the commercial segment, following the increase in supply and prices since the beginning of 2009. Overall, we believe that the inventory and affordability situation remains largely balanced in the residential segment but is more worrisome on the commercial side:

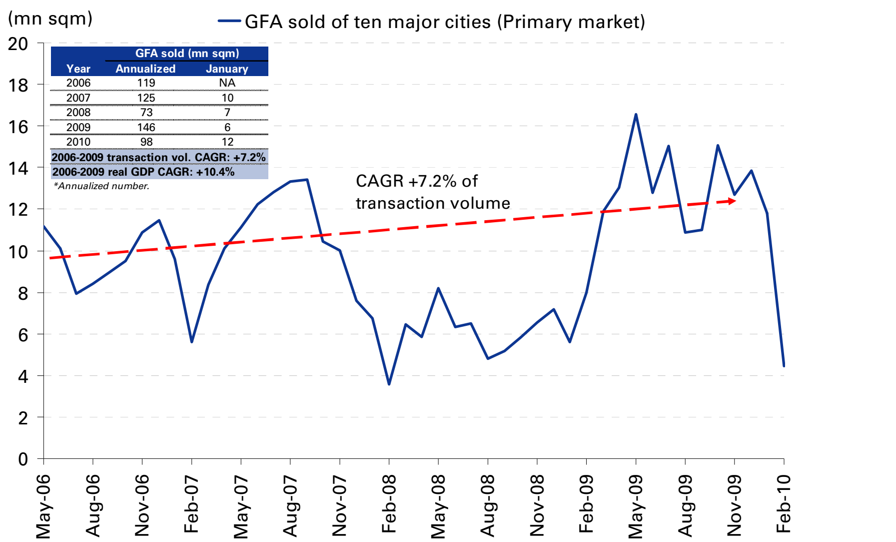
a. **"Trended" transaction volume growth of residential property looks reasonable:** While the residential property transaction volume may look strikingly high in both nominal and yoy growth terms in 2009, the compound annual growth rate (CAGR) of the aggregate transaction volume from 2006 to 2009 of 7.2% appears very reasonable, particularly against the strong economic growth in China during this period (Exhibit 21).

b. **Inventory profile has weakened probably due to seasonal effects.** The sequential contraction in transaction volume since the beginning of 2010 has resulted in a deterioration in the overall inventory picture. However, we are hesitant to read too much into this ratio given that the transaction volume is typically lackluster in the beginning of the year due to the Chinese New Year effect and annualizing a seasonally low base can produce misleading results. Moreover, even if we take the face value of the inventory ratio based on the annualized ytd volume, the ratio is still low relative to historical ranges.

c. **Affordability does not seem unreasonable, on average.** Exhibit 23 and 24 shows the mortgage debt service ratio for major 1st and 2nd tier cities in China. Except for Beijing and Shenzhen, where the debt service ratio has reached an all-time high, the overall housing affordability seems to be stable and remains in an acceptable range, in our view.

d. **Alarming signs in the commercial segment, but contagion risks appear manageable.** The supply-demand dynamics for commercial property look worrisome as the upcoming supply (GFA under construction) seems difficult to digest relative to the market demand (Exhibit 25). On the pricing side, prevailing selling prices do not seem to reflect market fundamentals as prices continue to stay high despite rising vacancy rates, suggesting the presence of speculative elements. However, we do not believe a potential commercial downturn would pose significant systemic risks to the banking sector or the overall economy given that: (1) office buildings only represent 2% of the total GFA sold and 3% of the aggregate GFA under construction in the Chinese real estate sector; and (2) banks' direct exposure to commercial building loans is small based on our analysts' estimates and should have limited impact on banks' balance sheets. Additionally, most of the real estate funding is domestic, so there is little cross-currency risk, and much of the commercial development is done by large corporate entities, so debt repayment is not solely reliant on property-specific cashflows but on the entity's broader earnings base.

Exhibit 21: The growth in transactions is reasonable relative to the rapidly expanding economy
Property transaction volume for 10 major cities in China



Year	GFA sold (mn sqm) Annualized	GFA sold (mn sqm) January
2006	119	NA
2007	125	10
2008	73	7
2009	146	6
2010	98	12
2006-2009 transaction vol. CAGR: +7.2%		
2006-2009 real GDP CAGR: +10.4%		

*Annualized number.

Exhibit 22: Residential inventory situation has increased due to the slowing transaction volume since the beginning of 2010, but inventory generally remains at moderate levels
Inventory (GFA available for sales) as % of sales

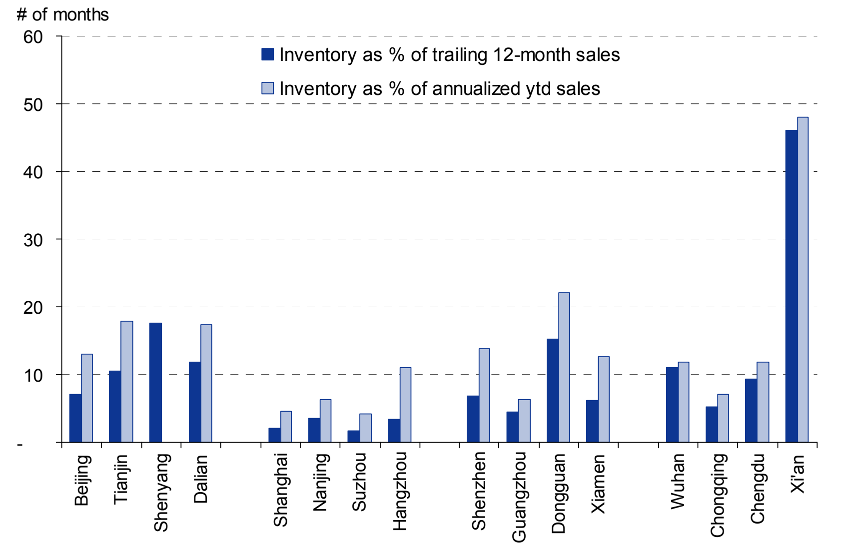


Exhibit 23: Overall affordability is within its historical range, although it has deteriorated in Beijing and Shenzhen
Housing affordability for major first-tier cities

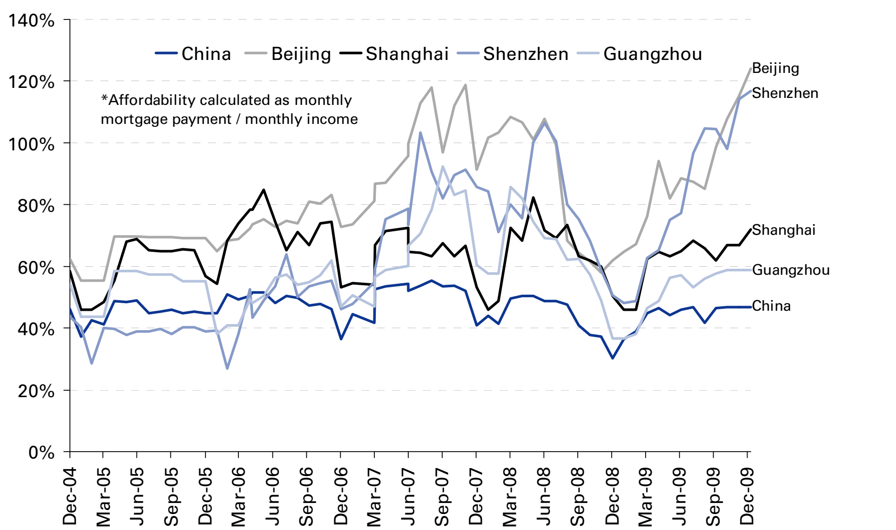
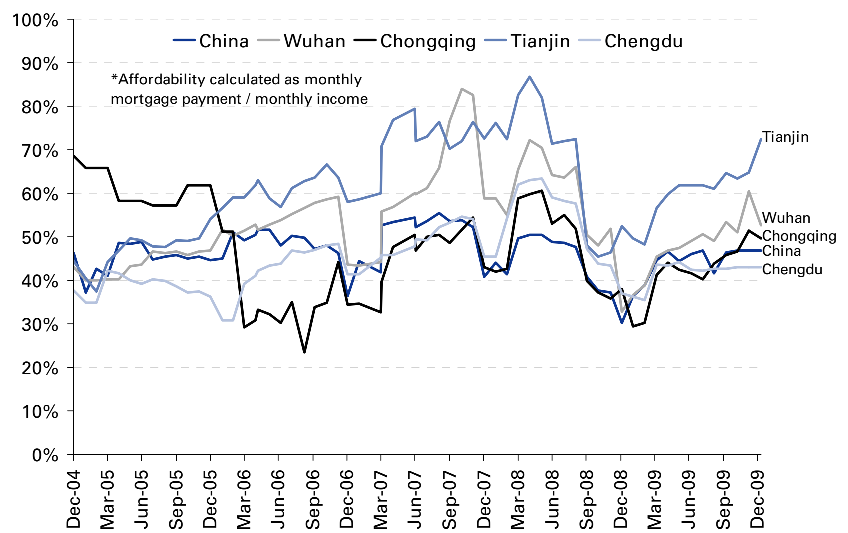


Exhibit 24: Affordability is largely stable in 2[nd]-tier cities
Housing affordability for major second-tier cities



Source: CIA, NBS, Goldman Sachs Research estimates.

Exhibit 25: Supply/demand picture looks more worrisome in the commercial property sector
GFA under development and GFA sold as % of trailing 12-month sales

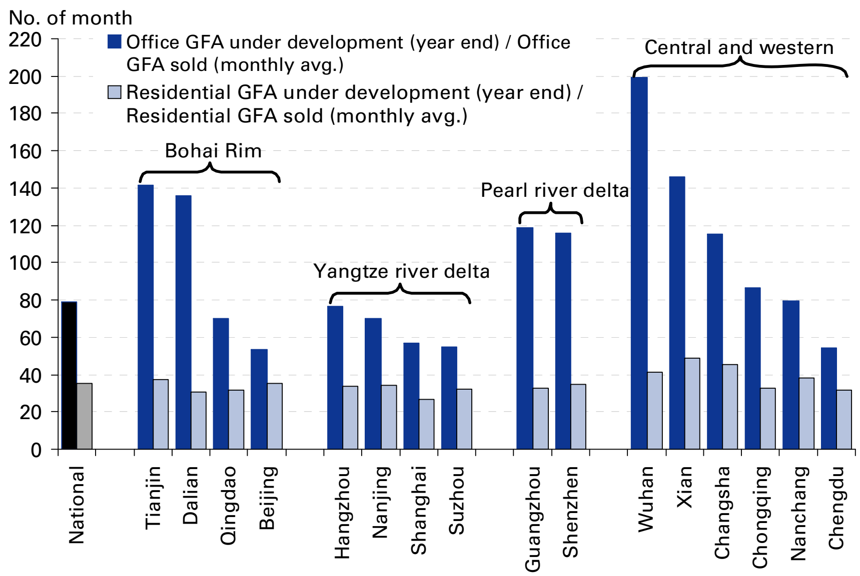


Exhibit 26: Signs of commercial real estate speculation: prices are high despite rising vacancy rates
Average selling prices and vacancy rates in Beijing (top) and Shanghai (bottom)

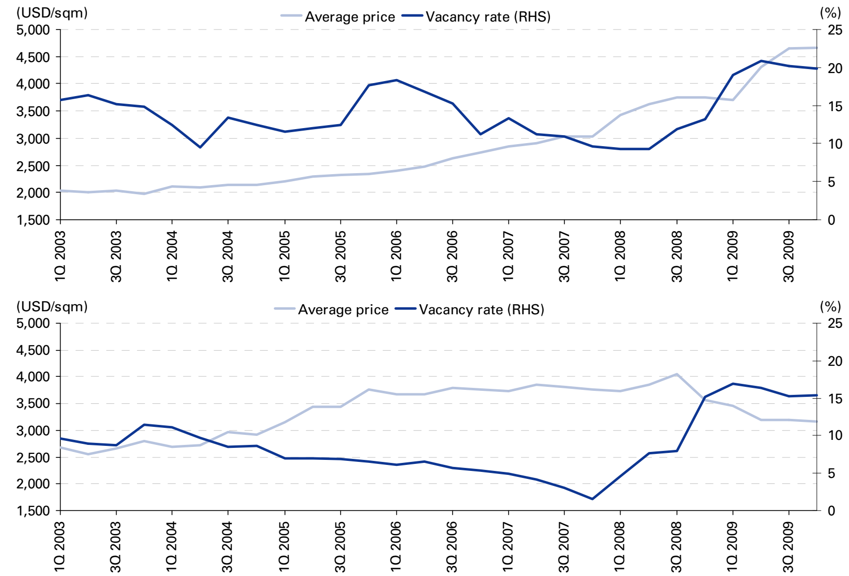


Exhibit 27: Systemic risks from commercial property appear low as it only represents a small portion of the aggregate real estate market
GFA sold by categories

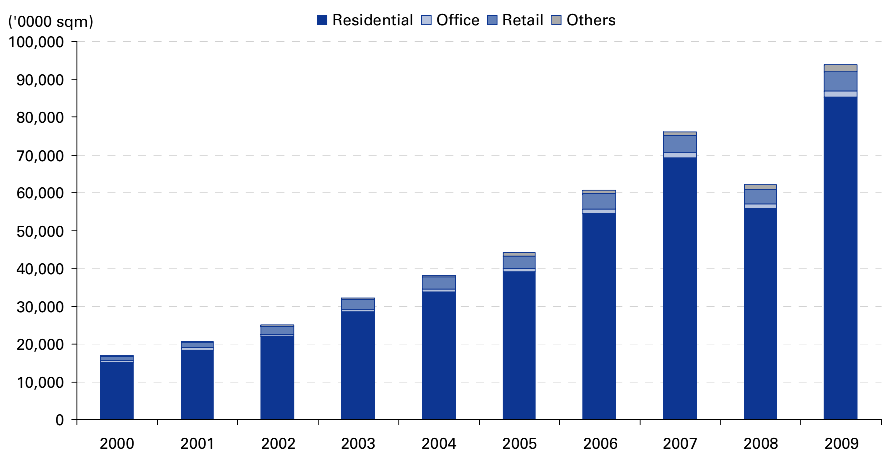
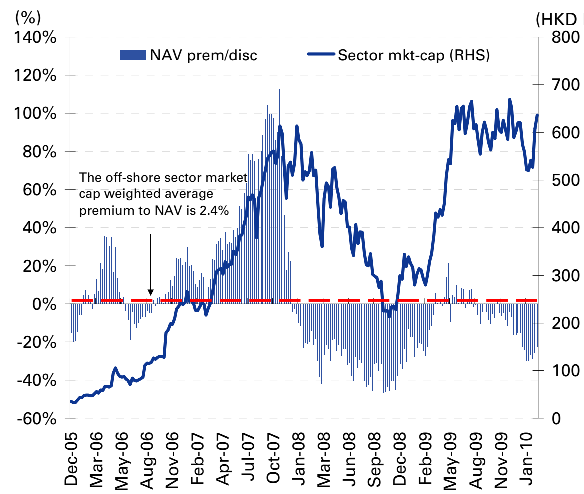


Exhibit 28: The steep discount to NAV for China property stocks may have priced in a large amount of risk
Price discount to NAV



Company	Ticker	Share price (disc)/prem to End-10E NAV (%)
Powerlong	1238.HK	(55)
Fantasia	1777.HK	(55)
Evergrande	3333.HK	(45)
R&F	2777.HK	(42)
Greentown China	3900.HK	(41)
Shui On Land	0272.HK	(40)
SOHO China	0410.HK	(38)
Shenzhen Investment	0604.HK	(37)
KWG	1813.HK	(37)
Shanghai Forte Land	2337.HK	(36)
Shimao Property	0813.HK	(33)
Agile Property	3383.HK	(32)
Sino Ocean	3377.HK	(32)
Country Garden	2007.HK	(27)
China Resources Land	1109.HK	(18)
Franshion	0817.HK	(16)
China Overseas Land	0688.HK	(14)
Simple average		**(35)**

Source: CIA, DataStream, NBS, Goldman Sachs Research estimates.

Focus issue 4—The National People's Congress: Pro-growth bias remains

The annual National People's Congress (NPC), the highest state body and the only legislative entity in China, began on March 5 and will close on March 14.

Based on historical precedent, we do not expect major policy surprises from the NPC and believe policymakers will likely to reiterate and officially endorse the policy objectives that they laid out in the Central Economic Working Conference (CEWC), which was held in December 2009.

Premier Wen presented his work report for 2010 on the first day of the NPC and we summarize the key policy objectives below (see Exhibit 29 for more detail and also see *China Views: Unsurprising but still interesting messages from the National People's Congress*, Mar 8). The overreaching policy objective is one of balanced growth; while this is likely to entail further normalization of policy after the significant stimulus during 2009, we believe the risk of excessive tightening and a 'hard landing' for China's economy is low.

- **Monetary and fiscal policy:** New bank loans are targeted to grow around 17% in 2010, translating into Rmb7.5 tn of new bank credits in 2010. While the target credit growth rate is lower than 15% in 2009, 18% growth nevertheless still represents accommodative financial conditions for activity growth, in our view. China will continue to run an expansionary fiscal policy in 2010, with the total fiscal deficit being set at around 2.8% (Rmb1.05 tn) of the government expected 2010 GDP.
- **Inflation and FX:** The average target CPI inflation is 3% but many other government officials have voiced their concerns on rising inflationary pressures. The CNY exchange rate will be kept "basically stable" at an "appropriate and balanced" level (i.e. the exchange rate could move if current level is deemed inappropriate) and the report explicitly mentioned that the government will continue to improve the mechanism for setting the exchange rate going forward.
- **Domestic consumption:** The government has announced a slew of policies, such as extending the direct consumption subsidy programs for autos and home appliances, raising the subsidy for basic medical insurance to Rmb120 (50% yoy growth) and refining the "hukou" system, to support job growth, incentivize consumption, and enhance the social safety net.
- **Developing the agriculture sector and rural communities**: Solving the "three-agricultural problems"—agricultural industry, rural areas, and farmers—is once again the top policy priority for the NPC this year. In aggregate, the government will commit over Rmb800 bn in supporting the development of rural areas in 2010, with a focus of improving the infrastructure buildup in the rural areas and increasing direct subsidy to farmers and raising the minimum purchasing price for selected agricultural products to boost farmers' income.
- **The property market**: Surging property prices have become the most topical issue in China and have sparked concerns among policymakers. The government will mainly rely on supply-side policies and administrative measures, including constructing more economic housing for low-income people and raising the penalty for land hoarding and price rigging, to resolve this problem.
- **Refining the growth profile.** Policy makers aim to address overcapacity issues in some industries and improving the quality and efficiency of overall economic growth, with a strong focus on renewable and clean energy projects.

Exhibit 29: Policy measures focus on sustained, balanced growth
A summary of the work report for 2010

NPC work report for 2010	
Major targets for 2010	• GDP will grow by around 8%, with a focus of rebalancing the economic structure with increasing weight on tertiary industry. • Urban employment will increase by more than 9 mn people and urban registered unemployment rate will be kept no higher than 4.6%, compared to a 2009-end level of 4.3%. • CPI will be around 3%.
Details	
Monetary policy	• To continue to implement a moderately easy monetary policy in 2010. The total quantity of Rmb loans will be increased by approximately Rmb7.5 tn, about 17% growth yoy.
Fiscal policy	• A deficit of Rmb1.05 tn has been projected, consisting of Rmb850 bn in central government deficit and Rmb200 bn in local government bonds which will be included in local government budgets. It will take up about 2.8% of the GDP. • To further implement fiscal stimulus to boost private consumption.
Currency policy	• To keep the exchange rate of Rmb at a stable and balanced level.
Investment	• To monitor the launching of new government projects in an effort to curb redundant investment, strengthen and improve the supervision of investment. • To encourage non-government investment through tax benefits.
Consumption	• To expand consumer industries such as media, tourism, e-commerce, cultural activities, bodybuilding, education and household service. • To increase rural residents' subsidies for household electrical appliances as well as automobiles.
SMEs	• To allocate Rmb10.6 bn for development of SMEs, simplify the approval process and extend more credit for financial support.
Employment	• To allocate Rmb43.3 Bn to stimulate employment. Focus will be on college graduates, rural migrant workers, and demobilized military personnel.
Property market	• To build 3mn basic residential house and allocate a subsidy of Rmb63.2 bn, an increase of Rmb8.1 bn from 2009, for the construction. • To increase the supply of small-medium sized commodity houses and facilitate the approval of housing construction projects. • To monitor the secondary market, promote the housing rental market and enhance the commodity house pre-sale system. • To make efforts to deal with violations of laws and regulations such as keeping land unused, property hoarding, and price rigging.
Agriculture	• To allocate Rmb818.3 bn for rural areas, an increase of Rmb93 bn from 2009. Up to Rmb133.5 bn will be spent to subsidize agricultural production, a increase of Rmb6.04 bn yoy. • To offer a rise of Rmb0.06 to Rmb0.2 in the minimum price of rice per kg and a Rmb0.06 rise for wheat. • To increase the financial support for rural areas of intensive wheat and livestock production and provide clean water for 60 mn more villagers.
Education	• Education reform will be conducted in operating schools in terms of curricula, teaching methods, and evaluation systems. • The annual amount of government investment in education will increase to 4% of GDP by 2012.
Social safety net	• To move forward with the pilot program for a new insurance system for rural residents by expanding it to 23% of the country's counties. • To relax hukou restrictions and ensure migrant workers receive the same treatment as urban residents in terms of pay, children's education, healthcare, housing, and social security. • To allocate Rmb318.5 bn more into the social security system and increase the basic retirement benefit for enterprises' employees by 10%. • To grant work-injury insurance coverage for all the 1.3 mn aged and injured employees in the country.
Healthcare	• To raise government subsidies and personal contributions on basic medical insurance for non-working urban residents and on the new rural cooperative medical care system to Rmb120 per capita per year, a 50% up yoy. • To implement the basic medicine system in 60% of government primary medical houses and reinforce the central purchasing and logistics of the medicine.
Energy & climate change	• To increase the energy-saving capacity by an equivalent of 80 mn tonnes of standard coal, focusing on industries of transportation, industrials and construction. • To develop low-carbon technologies and build an industrial system and consumption pattern with low carbon emissions.
Western & central area	• To accelerate the urbanization of western and central areas and renew the deteriorating heavy industrial areas in north-east. • To emphasize on Tibet and Xinjiang's economic, city infrastructure and social development.
Cross-strait	• To encourage qualified enterprises to invest in Taiwan, set up an economic cooperation mechanism by signing an economic cooperation framework agreement (ECFA).

Source: GS Global ECS Research.

Theme 1: Picking the Chinese consumption winners

China is arguably one of the most promising investment cases in global equity markets today, and domestic consumption is perceived by many market participants, including ourselves, as the best investment theme in China's equity universe for a number of macro and micro reasons.

That said, consumer exposure is a broad concept and ultimately demand for all products and services is linked — directly or indirectly — to consumption demand, the performance of consumer-related equities can vary significantly (Exhibit 30). To help investors systematically and objectively analyze the growth prospects and the investment attractiveness relative to the current valuations of various consumer subsectors in China, we adopt the following logic and methodology:

- We start with comparing China's current: (a) consumption level; (b) prevailing product selling prices; and (c) company profitability, to its regional and global comparables.
- We assume China's overall living standard, measured by per capita GDP, matches the average of Taiwan's and Korea's levels in 2020, which is consistent with our economists' long-term growth forecasts on the BRIC economies. Similarly, we assume Chinese consumption volume, product selling prices, and company profitability reach Taiwan's and Korea's levels in 10 years' time. We elect to use Taiwan and Korea as our benchmarks given their close cultural proximity and relatively similar consumer preferences compared with China.
- A combination of the above assumptions could give us a broad sense of how much earnings can grow in various consumer sectors over a 10-year period.
- We calculate the "fair" valuations based on our projected earnings trajectory, which follows a half-life decay process after 10 years, using a long-term Dividend Discount Model (DDM).
- We are mindful of the potential logical flaws of extrapolating product ASP and profitability from a set of universe (i.e. China versus Korea and Taiwan) of which industry structure and regulatory environment are different. However, we still believe this top-down earnings analysis approach offers a systematic way to estimate the potential growth rates in different consumer sectors in China.

Our macro growth assumptions and our top-down earnings analysis suggest that (also see Exhibit 31 and 32):

- The **healthcare** and **insurance** sectors appear best positioned to deliver secular growth in the Chinese consumer space and market size growth is likely to be the most influential factor in driving equity returns in the **auto, dairy, PC** and **internet** sectors given a high degree of unsatisfied demand (low product penetration rate);
- The solid and visible growth prospects of the **telecom** sector seem underappreciated relative to its attractive valuations; and
- Consumer staples including **beer, clothing, footwear** and **noodles** may need to rely on product upgrades (ASP increases) and/or industry consolidation to exploit growth opportunities, as the competitive landscape is relatively mature and room for monetizing unfulfilled demand is rather limited, in our view.

We have created two new consumer CATs (**GSSZCNCO** and **GSSZCNCA)** which comprise companies with superior sectoral growth prospects, good fundamentals and reasonable valuations for macro investors who look for diversified, thematically appealing exposure to the Chinese consumer market.

Exhibit 30: Performance has varied significantly among Chinese consumer sectors

Relative performance of consumer sectors since 2004

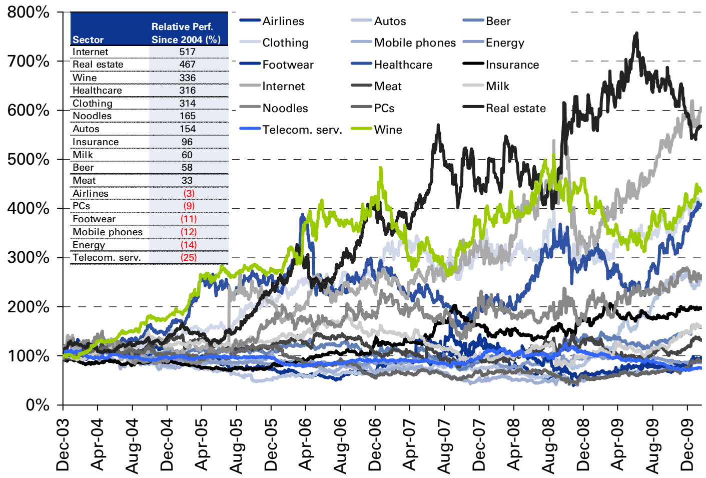


Exhibit 31: We see different consumer sectors falling into four distinct categories in terms of their investment appeal to investors

Long-term investment appeal segmentation

Volume beneficiaries	ASP upgraders
Autos Airlines Mobile phones Milk PCs Insurance Internet	Beer Clothing Footwear Healthcare Insurance Real estate Wine
Margin winners	**GARP**
Beer Healthcare Milk Noodles PCs	Energy Telecom

Exhibit 32: Healthcare and insurance sectors seem to boast the highest earnings growth potential among other consumer subsectors in the next decade, according to our top-down analysis

Our estimated 10-year EPS CAGR for different consumer sectors in China

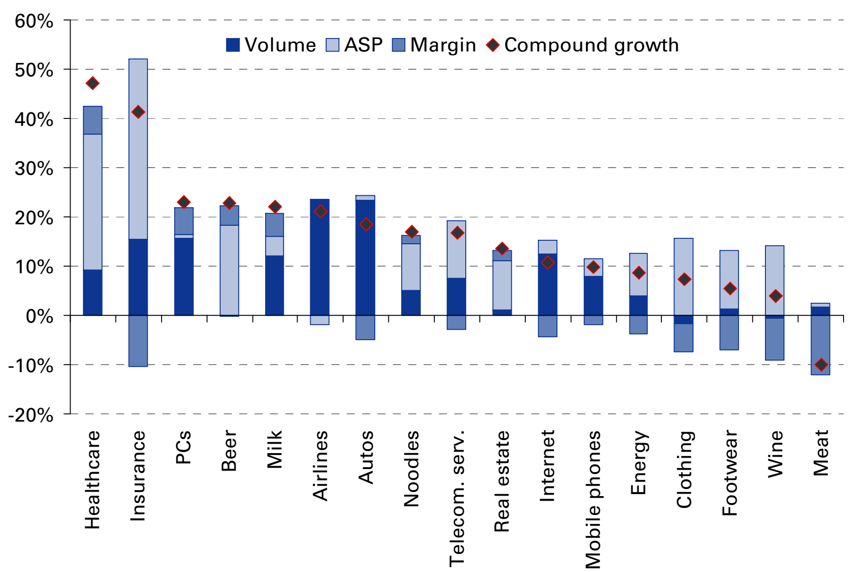


Exhibit 33: Our preferred exposure to the Chinese consumer space

GSSZCNCO and GSSZCNCA—Lists of names and valuations based on calendarized I/B/E/S median estimates

Ticker	Stock name	Total market cap (US$ mn)	GS Rating	Price (Quoted)	Quoted currency	6M GSLE (US$ mn)	CY10E P/E (X)	CY10E EPS growth (%)	CY10E P/B (X)	CY10E D/Y (%)	CY10E ROE (%)
2628 HK	China Life Insurance (H)	115,350	N	34.4	HKD	144.1	23.5	14.9	3.4	1.2	12.6
2601 HK	China Pacific Insurance (Group) Co. Ltd.	31,905	N	31.3	HKD	26.0	25.5	20.0	2.4	1.1	7.7
762 HK	China Unicom	29,472	B*	9.7	HKD	24.9	24.7	(21.2)	0.9	1.5	4.8
BIDU UW	Baidu.com (ADR)	18,169	B	520.8	USD	569.1	54.9	51.5	17.4	—	20.9
753 HK	Air China (H)	17,220	N	6.8	HKD	9.2	17.5	(11.7)	2.5	1.0	16.4
688 HK	China Overseas Land & Inv	17,427	N	16.6	HKD	35.6	16.0	30.9	2.8	1.3	13.5
322 HK	Tingyi Cayman Islands	14,163	N	19.7	HKD	6.4	29.8	25.1	8.2	1.6	21.9
489 HK	Dongfeng Motor	13,053	NC	11.8	HKD	21.2	12.5	15.8	2.7	0.7	18.6
763 HK	ZTE (H)	12,480	N	48.3	HKD	9.0	23.0	32.2	3.7	0.9	12.3
1099 HK	Sinopharm Group Co. Ltd.	9,568	N	32.8	HKD	22.6	50.4	24.6	5.5	0.5	8.7
168 HK	Tsingtao Brewery (H)	6,736	N	38.4	HKD	4.6	29.5	19.7	5.1	1.7	14.4
992 HK	Lenovo	6,501	B	5.2	HKD	21.2	25.1	382.2	3.8	0.9	3.2
2319 HK	China Mengniu Dairy	5,371	B*	24.0	HKD	11.2	23.4	19.1	3.8	0.9	13.8
MR UN	Mindray Medical Intl (ADR)	4,100	B	38.0	USD	18.3	26.4	17.1	5.5	0.8	17.8
SINA UW	Sina	2,384	B	40.9	USD	26.5	28.3	22.5	1.9	—	5.6

Ticker	Stock name	Total market cap (US$ mn)	GS Rating	Price (CNY)	6M GSLE (US$ mn)	CY10E P/E (X)	CY10E EPS growth (%)	CY10E P/B (X)	CY10E D/Y (%)	CY10E ROE (%)
601628 CG	China Life Insurance (A)	115,350	N	27.0	52.5	23.5	22.2	3.7	1.8	13.0
601601 CG	China Pacific Insurance	31,905	B*	24.5	76.8	31.2	15.8	3.0	0.8	8.2
600519 CG	Kweichow Moutai	22,731	B	164.4	43.2	25.3	28.1	8.1	1.2	25.0
600050 CG	China United Network	20,276	N	6.5	120.8	38.9	(6.1)	1.8	1.0	5.0
600104 CG	SAIC Motor	21,086	NC	22.0	41.5	14.6	48.4	2.9	1.3	13.2
000002 CS	China Vanke (A)	14,713	B	9.4	120.7	14.9	30.6	2.4	1.1	12.4
000063 CS	ZTE (A)	12,480	N	45.1	40.7	24.4	33.1	3.9	0.7	12.1
600600 CG	Tsingtao Brewery (A)	6,736	N	34.3	9.6	27.9	28.7	5.5	1.7	15.4
600029 CG	China Southern Airlines (A)	6,307	B	6.6	27.7	35.8	172.1	4.3	—	4.4
000800 CS	FAW Car	5,536	NC	23.2	28.5	21.7	25.9	4.2	1.2	15.3
600383 CG	Gemdale	4,509	B	12.4	83.3	16.3	35.7	1.8	1.2	8.1
000729 CS	Beijing Yanjing Brewery	3,650	N	20.6	18.0	29.6	33.7	3.2	1.2	8.1
600887 CG	Inner Mongolia Yili Ind	3,521	B	30.1	17.9	27.6	31.7	5.9	0.7	16.1
002001 CS	Zhejiang NHU	2,642	B	48.4	12.4	11.7	29.5	3.5	0.6	23.4
600535 CG	Tianjin Tasly Pharma	1,949	B	27.3	11.0	32.7	26.3	6.0	1.9	14.7

** On our Regional Conviction List*

Source: Datastream, FactSet, I/B/E/S, Worldscope, GS Global ECS Research.

Where does China stand in terms of its consumption level, product ASP, and profitability relative to its regional and global peers?

Exhibit 34: Parameters in our analysis at a glance

Volume Sector	Parameter	CN	TW	KR	US	JP	TW+KR average	US+JP average	TW+KR+US+JP average	Source
Airlines	No. of passengers carried / total population	0.2	1.5	1.4	3.3	0.8	1.5	2.0	1.8	*CN, TW, KR, US, JP (All 2009): CEIC.*
Autos	No. of car / 1000 capita	38.7	291.9	345.5	819.4	595.6	318.7	707.5	513.1	*CN, TW, US, JP (All 2008): Global Insights; KR (2008): KAMA, GS Global ECS Research.*
Beer	Litres per capita at legal drinking age	39.5	27.3	49.9	115.1	60.5	38.6	87.8	63.2	*CN, TW, KR, US, JP (All 2008): Euromonitor.*
Clothing	Retail units / capita	17.9	22.3	7.8	33.2	18.5	15.0	25.9	20.4	*CN, TW, KR, US, JP (All 2008): Euromonitor.*
Mobile phones	No. of mobile phone / capita	0.5	1.1	0.9	0.9	0.9	1.0	0.9	0.9	*CN, TW, KR, US, JP (All 2008): CIA, GS Global ECS Research.*
Energy	Tonnes oil equivalent per capita	1.1	1.7	1.4	1.8	1.0	1.6	1.4	1.5	*CN, TW, KR, US, JP (All 2008): BP.*
Footwear	Retail units / capita	1.6	2.0	1.8	3.4	2.5	1.9	3.0	2.4	*CN, TW, KR, US, JP (All 2008): Euromonitor.*
Healthcare	No. of hospital bed / 1000 capita	3.1	5.7	9.0	3.6	14.0	7.4	8.8	8.1	*CN (2008): MOH; TW, KR, US, JP (All 2006): WHO, World Bank.*
Insurance	Premium as % of GDP	3%	16%	12%	9%	10%	14%	9%	12%	*CN, TW, KR, US, JP (All 2008): Swiss Re Sigma Research.*
Internet	Internet penetration rate	22%	66%	77%	75%	72%	72%	73%	72%	*CN, TW, KR, US, JP (All 2008): CIA, GS Global ECS Research.*
Meat	Kg / capita	54.0	76.9	50.0	123.0	43.0	63.5	83.0	73.2	*CN, TW, KR, US, JP (All 2003): FAO.*
Milk	Litres per capita	6.3	14.8	24.3	88.2	35.5	19.6	61.9	40.7	*CN, TW, KR, US, JP (All 2008): Euromonitor.*
Noodles	Instant noodles (kg) / capita	3.0	2.2	7.5	0.5	3.8	4.9	2.1	3.5	*CN, TW, KR, US, JP (All 2008): Euromonitor.*
PCs	Home PC / 1000 households	190	893	732	1,323	711	813	1,017	915	*CN, TW, KR, US, JP (All Oct 2009): Gartner.*
Real estate	Floor space of residential buildings (sq. m) / capita	29.9	47.6	19.3	68.3	36.7	33.4	52.5	42.9	*CN, TW, KR, US, JP (All 2008): Various Bureaus of Statistics.*
Telecom. serv.	Mobile penetration (%)	48%	105%	94%	89%	83%	99%	86%	93%	*CN, TW, KR, US, JP (All 2008): Country telecom regulatory body.*
Wine	Litres / capita at legal drinking age	0.9	0.7	1.0	11.1	2.3	0.9	6.7	3.8	*CN, TW, KR, US, JP (All 2008): Euromonitor.*
ASP Sector	**Parameter**	**CN**	**TW**	**KR**	**US**	**JP**	**TW+KR average**	**US+JP average**	**TW+KR+US+JP average**	**Source**
Airlines	Airfares / km (USD cents / RPK)	9.1	6.6	8.4	8.7	16.8	7.5	12.7	10.1	*CN, TW, KR, US, JP (All 2009): Company data, GS Global Equity Research.*
Autos	ASP ('000 USD / unit)	16	17	19	26	14	18	20	19	*CN, TW, KR, US, JP (All 2009): Company data, GS Global Equity Research.*
Beer	ASP (USD / litre)	1.0	4.3	6.0	3.5	7.3	5.2	5.4	5.3	*CN, TW, KR, US, JP (All 2008): Euromonitor.*
Clothing	ASP (USD / unit)	5.9	13.4	37.5	28.1	48.6	25.4	38.3	31.9	*CN, TW, KR, US, JP (All 2008): Euromonitor.*
Mobile phones	Wholesale price (USD / unit)	208	260	330	191	411	295	301	298	*CN, KR, US, JP (All 3Q 2009): Dataquest; TW (2009): NOVA.*
Energy	Retail price (USD cents / KWH)	3.4	7.1	8.6	8.7	20.7	7.9	14.7	11.3	*CN, TW, KR, US, JP (All 2005): International Energy Agency.*
Footwear	ASP (USD / unit)	12.6	47.6	29.8	41.0	60.7	38.7	50.8	44.8	*CN, TW, KR, US, JP (All 2008): Euromonitor.*
Healthcare	Exp. per capita (USD)	94	973	1,168	6,719	2,759	1,071	4,739	2,905	*CN (2007): MOH; TW, KR, US, JP (All 2006): WHO.*
Insurance	Premium per capita (USD)	105	2,788	1,969	4,078	3,699	2,378	3,888	3,133	*CN, TW, KR, US, JP (All 2008): Swiss Re Sigma Research.*
Internet	Online shopping revenue / internet user (USD)	999	479	2,188	1,276	1,858	1,334	1,567	1,450	*CN, KR, JP (All 2007): Mastercard; TW (2007): Market Intelligence Center; US (2007): Census Bureau.*
Meat	Producer price (USD / kg)	3.4	3.5	3.9	1.4	3.2	3.7	2.3	3.0	*CN, KR, US, JP (All 2007): FAO; TW: Council of Agriculture, Executive Yuan R.O.C. (2007).*
Milk	ASP (USD / litre)	1.0	1.4	1.8	1.1	1.5	1.6	1.3	1.4	*CN, TW, KR, US, JP (All 2008): Euromonitor.*
Noodles	ASP (USD / kg)	2.2	6.7	4.3	6.2	14.2	5.5	10.2	7.9	*CN, TW, KR, US, JP (All 2008): Euromonitor.*
PCs	ASP of a standard desktop computer (USD / unit)	423	444	474	449	644	459	547	503	*CN, TW, KR, US, JP (All 2009): Company data, GS Global Equity Research.*
Real estate	ASP of an apartment in city center (USD / sq. m.)	2,600	4,200	9,266	9,000	10,367	6,733	9,684	8,208	*CN (Beijing), KR (Seoul), US (New York), JP (Tokyo) (All 2010): Numbeo; TW (Taipei) (2009): Numbeo.*
Telecom. serv.	ARPU (USD)	8.7	21.8	31.4	46.9	72.9	26.6	59.9	43.3	*CN, TW, KR, US, JP (All 2009): Company data, GS Global Equity Research.*
Wine	ASP (USD / kg)	8.1	28.8	32.3	11.9	22.0	30.5	17.0	23.7	*CN, TW, KR, US, JP (All 2008): Euromonitor.*
Margin Sector	**Parameter**	**CN**	**TW**	**KR**	**US**	**JP**	**TW+KR average**	**US+JP average**	**TW+KR+US+JP average**	**Source**
Airlines	Net Margin	1.8%	-1.9%	0.5%	-9.0%	2.0%	-0.7%	-3.5%	-2.1%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Autos	Net Margin	6.2%	6.6%	0.9%	-1.6%	5.3%	3.8%	1.9%	2.8%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Beer	EBITDA Margin	17.3%	NA	25.8%	20.1%	9.7%	25.8%	14.9%	18.5%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Clothing	Net Margin	17.0%	6.6%	12.4%	9.8%	6.1%	9.5%	7.9%	8.7%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Mobile phones	Net Margin	15.8%	13.1%	NA	-0.1%	NA	13.1%	-0.1%	6.5%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Energy	Net Margin	8.6%	8.4%	3.3%	12.7%	7.7%	5.8%	10.2%	8.0%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Footwear	Net Margin	8.7%	3.4%	5.0%	6.9%	9.2%	4.2%	8.0%	6.1%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Healthcare	Net Margin	10.3%	17.0%	19.0%	19.4%	7.3%	18.0%	13.4%	15.7%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Insurance	Net Margin	9.4%	3.9%	2.3%	7.8%	2.5%	3.1%	5.2%	4.1%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Internet	Net Margin	31.3%	NA	20.2%	18.5%	21.4%	20.2%	20.0%	20.0%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Meat	Net Margin	6.4%	NA	1.8%	2.1%	-0.1%	1.8%	1.0%	1.3%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Milk	Net Margin	2.9%	NA	4.6%	2.2%	0.7%	4.6%	1.5%	2.5%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Noodles	Net Margin	5.1%	NA	6.1%	NA	4.8%	6.1%	4.8%	5.4%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
PCs	Net Margin	1.4%	3.0%	1.8%	8.6%	0.8%	2.4%	4.7%	3.6%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Real estate	Net Margin	19.1%	23.5%	NA	-12.2%	6.3%	23.5%	-3.0%	5.9%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Telecom. serv.	EBITDA Margin	55.3%	47.1%	36.1%	31.7%	25.2%	41.6%	28.4%	35.0%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*
Wine	Net Margin	28.3%	NA	11.7%	9.8%	2.7%	11.7%	6.2%	8.1%	*2005 - 2009 data: I/B/E/S, Worldscope, GS Global ECS Research.*

Note (1): The numbers for ASP and volume are based on aggregate industry-wide statistics while net and EBITDA margins are calculated based on our selected company universe, as shown in Exhibit 21 on page 36.

Note (2): We estimate the 10-year EPS CAGR for a number of Chinese consumer sectors based on the current consumption pattern of Taiwan and Korea (i.e. the average of Taiwan and Korea). The numbers from Japan and the US are for illustrative purposes only.

Source: FactSet, I/B/E/S, Worldscope, GS Global ECS Research.

Taiwan: Strategically positive

Recovering earnings and improving China linkages underpin our overweight stance, despite 2Q tech-related seasonality headwinds

Earnings recovery in full swing: Consensus earnings growth for 2010 is now 80%, but we expect 97% growth this year. We also think the street's 18% 2011 expectations are low, since this would imply aggregate profits still below the level in 2007: we think EPS growth could be in the high 20% range. The drivers for the heavyweight tech sector are margin expansion and sales growth spurred by PC replacement cycle and emerging market demand.

Growth and China optionality not priced in. On consensus earnings, Taiwan trades at 13.5X forward P/E and 2.0X trailing P/B. We regard this as inexpensive given potential upside EPS revisions and closer China ties.

TW tech sector faces 2Q seasonal headwind: As tech companies traditionally see slower sales momentum after Christmas and Chinese New Year period, our TW tech analysts expect headwinds in 2Q.

Cross-strait discussions in 2Q could rejuvenate market sentiment. The ECFA agreement may be signed in June. This may buffer tech seasonality.

Exhibit 35: Potential 2Q catalysts include further progress on cross-straits relations

Time Frame	Event - Catalyst (Impacted stocks)
March 15-19 (Tentative)	• 2nd official discussion on ECFA. Representatives are Foreign Trade Director-General Huang Chih-peng and director of the Taiwan, Hong Kong and Macau Affairs Department under China's Ministry of Commerce, Tang Wei • Will likely exchange "early harvest list"
March	Central Bank Policy Meeting - We expect CBC to remain on hold
May /June	5th SEF-ARATS meeting
May /June	Tentative date for signing of ECFA
1H10	2 or 3 more official discussions regarding ECFA
1H10	Second list of industries open to Chinese investments
December	Taipei City, Taipei County, Taichung, Tainan, and Kaohsiung mayoral elections

Exhibit 36: Taiwan earnings continue to recover rapidly

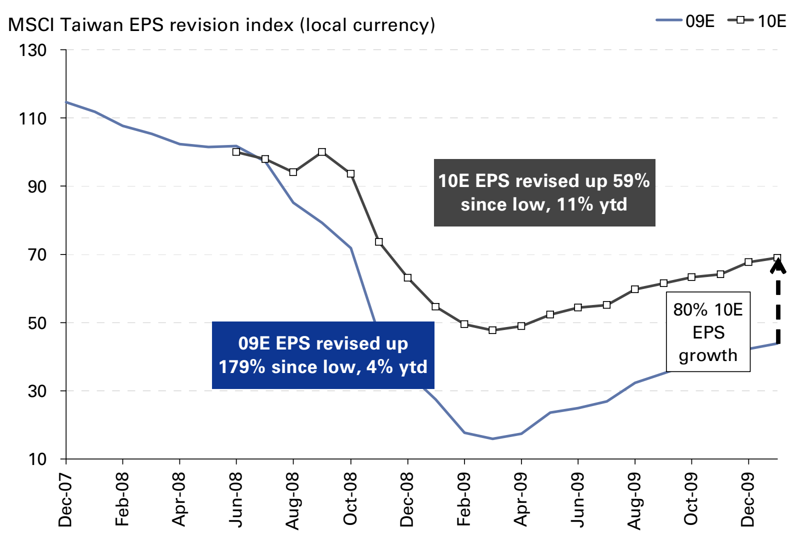
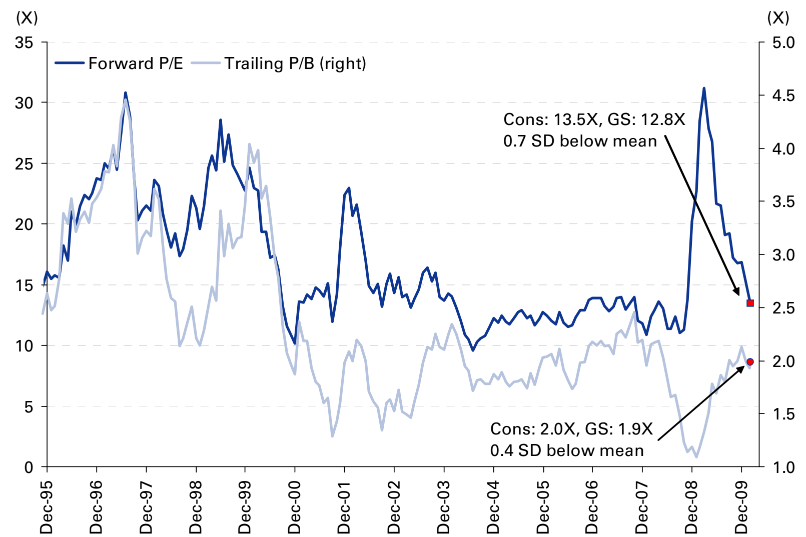


Exhibit 37: Taiwan's valuations are moderate and do not price in much upside from closer China economic ties



Sources: Company data, IDC, FactSet, I/B/E/S, Worldscope, Goldman Sachs Research estimates, GS Global ECS Research estimates.

Korea: affirming attractions

We remain overweight: low valuations and rapid earnings growth are the key reasons

Low policy risk: Our Korea economist believes the BoK is likely to keep interest rates on hold through 1H2010 given subdued inflationary pressure. We expect only moderate tightening in 2H.

Attractive valuation: Korea remains inexpensive vs. its own history (0.2x std dev below mean) and the regional market (0.5x std dev below mean).

Robust earnings growth: We continue to forecast 36% earnings growth in 2010 and consensus estimates have been revised up significantly to +39%. We believe the hurdle for consensus 2011 earnings remains quite low (+11%), which may provide further upside surprises as we approach 2H2010.

FX headwind manageable: We believe the recent success of Korea exports is not fully a function of a weak currency, but reflects competitive product offerings and a shift in geographic mix towards higher growth emerging markets.

Exhibit 38: Korea now exports more tech products to BRICs than G3
Korea tech export; data as of January 2010

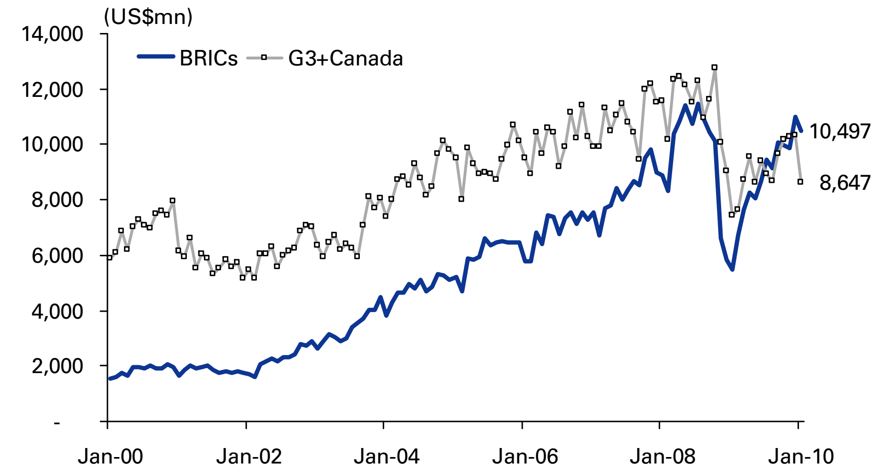


Exhibit 39: Korea's inflation is well within the target range of 2-4%; tightening pressure should be more subdued than other markets
Korea CPI inflation series

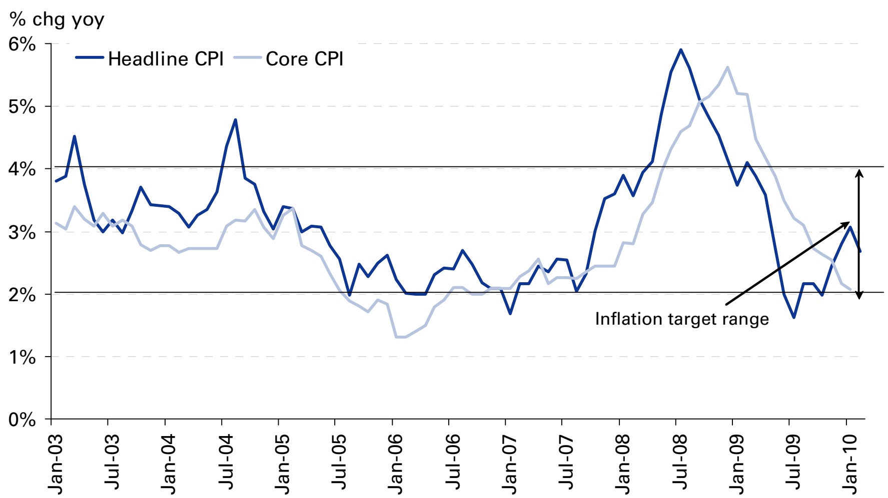
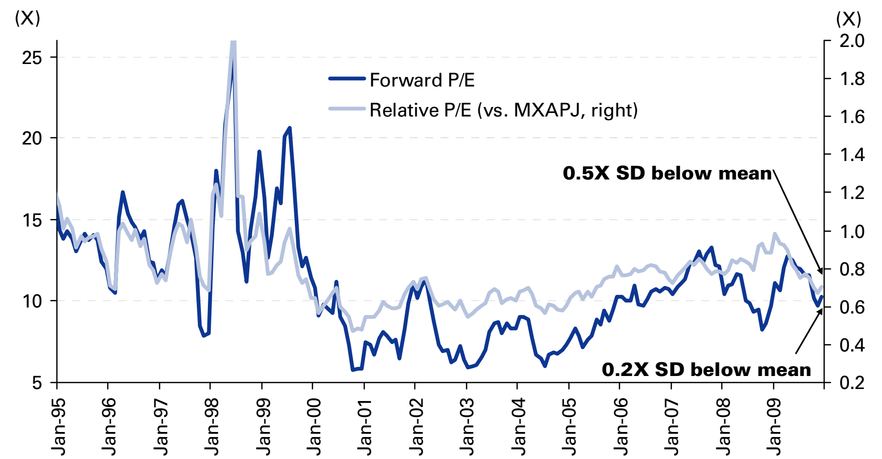


Exhibit 40: Korea P/E is low vs. regional market and its own history
Forward 12m P/E; data as of March 2010



Sources: CEIC, FactSet, I/B/E/S, MSCI, GS Global ECS Research estimates.

Decomposing price performance: performance attribution, earnings, valuations

Exhibit 41: Financials and global cyclicals have underperformed in a "risk-off" environment
Year-to-date USD performance of MXAPJ markets and sectors

Defensive ← **Domestic cyclicals** → **Global cyclicals**

Country weights ↑

	MXAPJ Country Wgt	MSCI Country Perf	Utilities	Telecom Services	Cons Staples	Health Care	Insur.	Divers. Finl	Banks	Real Estate	Cons Disc	Info Tech	Indus	Energy	Materials
Australia	28.4	0.8			2.1				2.9	-0.1				-1.5	1.2
China	18.7	-2.5		1.4			-6.5		-5.9				2.3	-2.1	
Korea	13.4	0.7							-1.0		-4.3	-0.1	6.5		-2.6
Taiwan	11.4	-5.2		-4.2				-12.3	-6.8			-6.0			2.9
India	8.1	1.3							5.3			4.3	2.2	-5.7	3.9
Hong Kong	7.8	0.7	1.1						-2.0	-2.6	13.2		7.8		
Singapore Free	4.8	-2.9		0.7	4.9				-6.3	-6.3			3.5		
Malaysia	3.0	5.5	1.5		3.9				11.8		1.3		1.7		
Indonesia	2.0	3.9		-4.8					3.9		15.1			3.2	3.0
Thailand	1.5	0.5		-7.7	-1.9				4.3					-1.7	1.8
Philippines	0.4	0.7	-6.3	3.7					-1.5	-1.7			14.1		
MXAPJ		-0.6	1.1	0.0	1.9	4.4	-7.7	-2.2	-0.1	-2.5	0.5	-2.9	3.3	-2.1	0.6
Sector Wgt			3.1	5.3	6.0	1.3	4.1	2.6	20.8	7.2	5.9	13.7	8.8	7.7	13.4

<< outperformance vs. MSCI country index
<< underperformance vs. MSCI country index

Source: FactSet, MSCI, GS Global ECS Research.

Exhibit 42: After a 13% pullback from January high then a 10% rebound, the region is now back to the level when 2010 started
MXAPJ price performance chart (short-term)

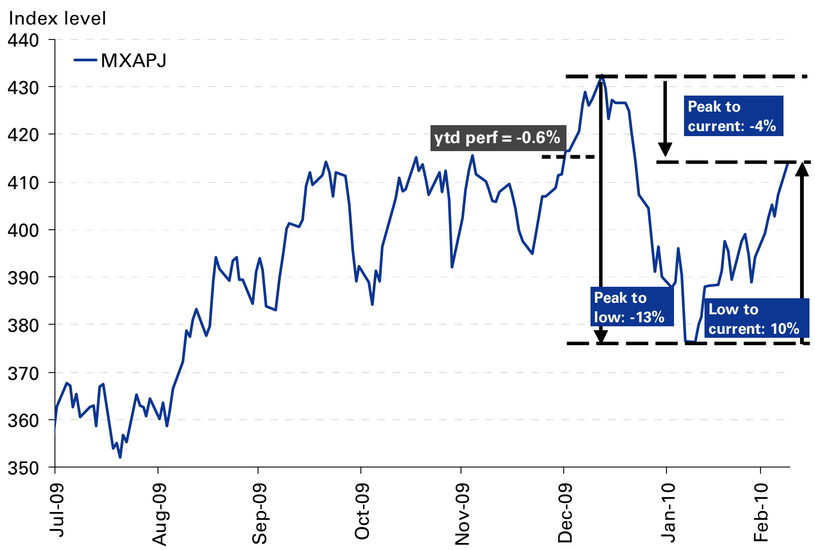


Exhibit 43: On a longer-term history, current levels are still 30% below 2007 high
MXAPJ price performance chart (long-term)

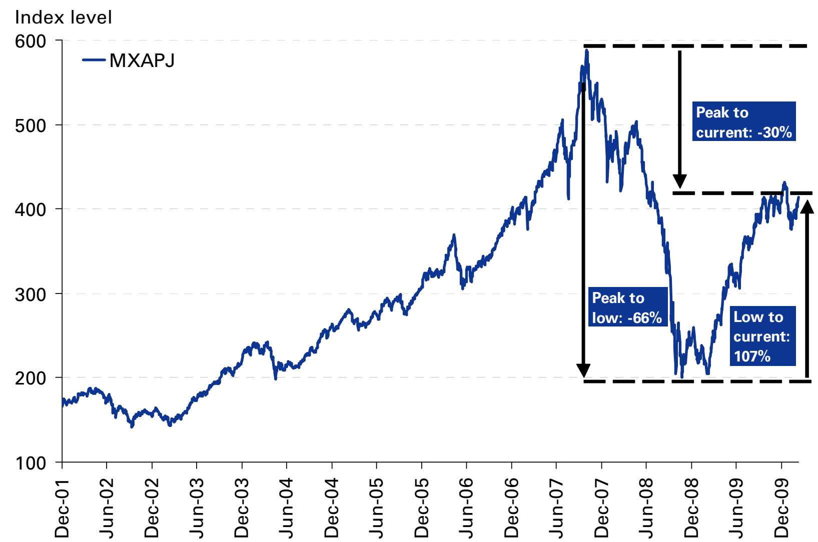
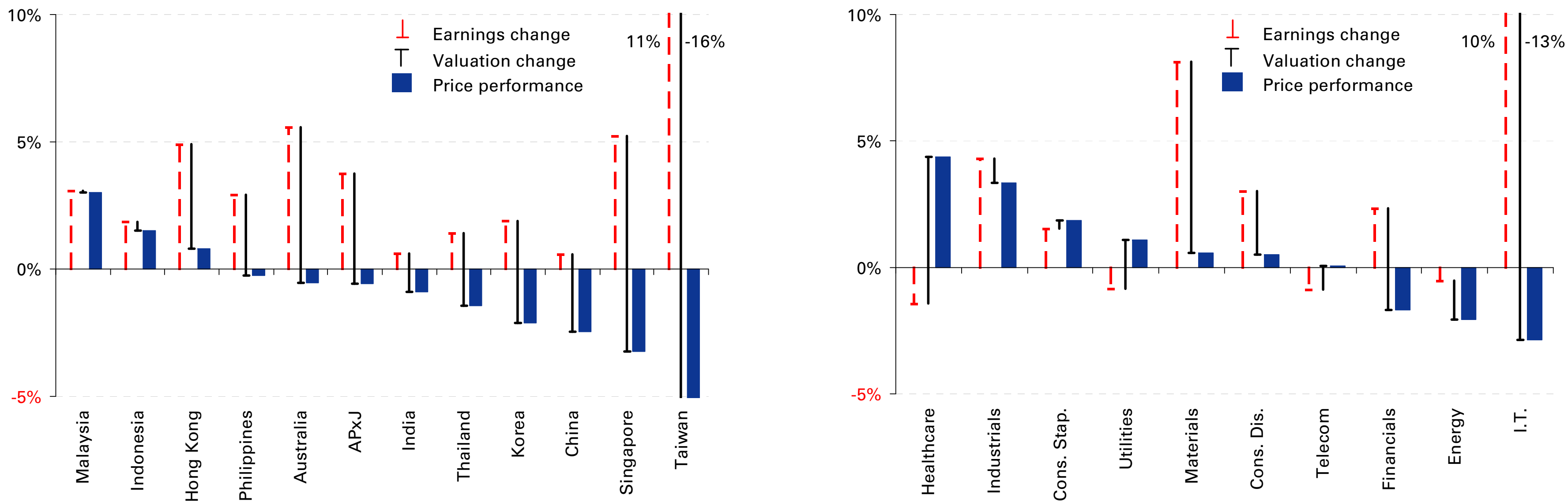


Exhibit 44: Valuation compression has outweighed earnings upgrades driving a pullback in most Asian markets and sectors
Price performance decomposition into earnings and valuation changes for MSCI market indices (left) and MXAPJ sector indices (right)



Source: FactSet, I/B/E/S, MSCI, GS Global ECS Research.

Economic backdrop

Exhibit 45: We expect over 4% global GDP growth in 2010 and 2011, with substantial differences between Asian regional economies and the G3

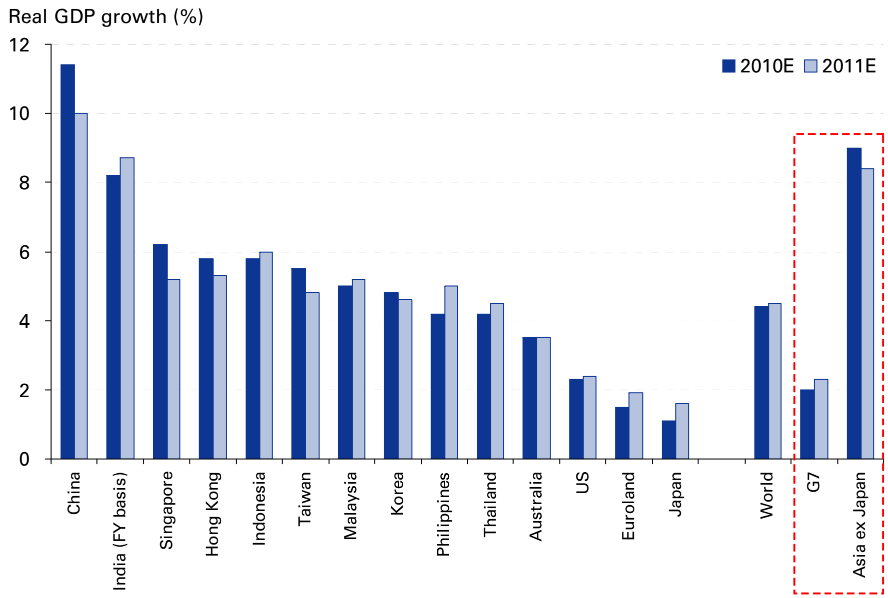
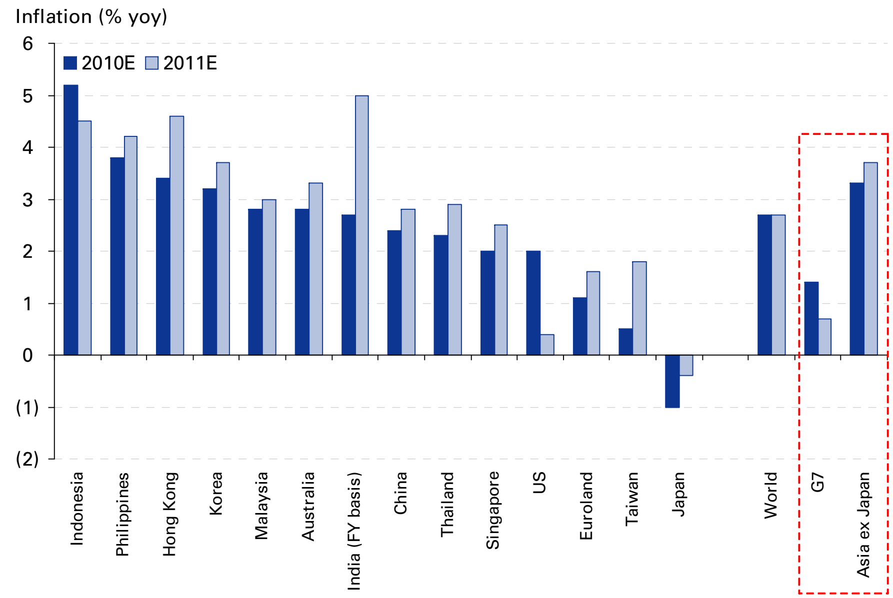


Exhibit 46: Higher Asian growth will spur inflation pressures as output gaps close; early Asian policy tightening is a key macro theme this year



Source: GS Global ECS Research estimates.

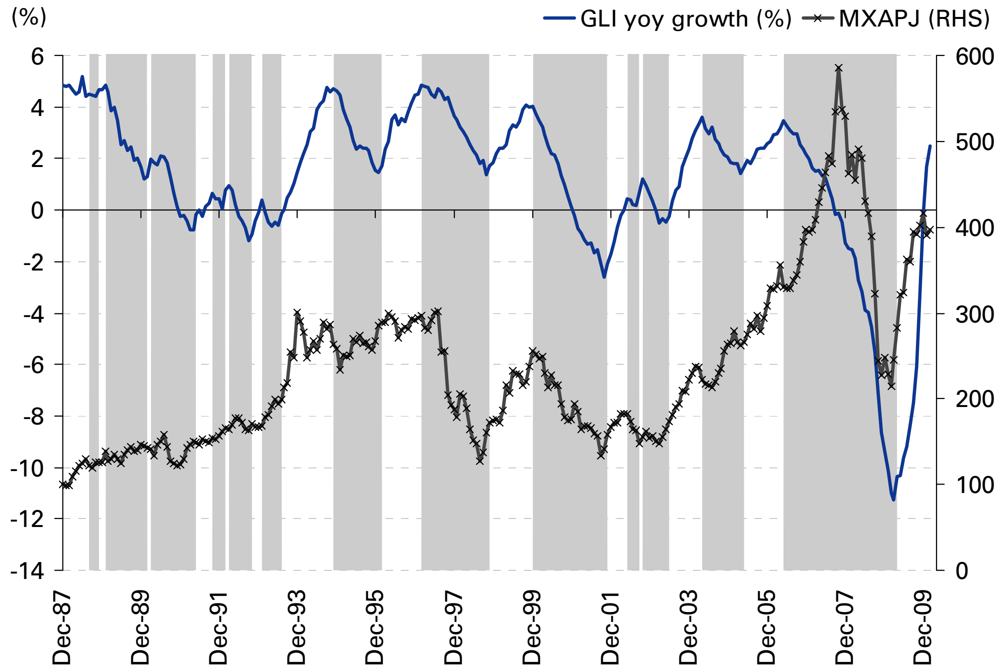
Exhibit 47: Our economists expect most regional Asian currencies to appreciate vs. USD; they look for JPY to weaken

		3-month		6-month		12-month	
Exchange rates	**Current**	**Forward**	**Forecast**	**Forward**	**Forecast**	**Forward**	**Forecast**
$/CNY	6.83	6.77	6.83	6.72	6.83	6.64	6.49
$/HKD	7.76	7.76	7.8	7.75	7.8	7.74	7.8
$/TWD	31.9	31.6	31	31.3	30.5	30.9	30.5
$/KRW	1137	1136	1150	1138	1100	1144	1050
$/SGD	1.4	1.4	1.4	1.4	1.38	1.4	1.35
$/IDR	9180	9260	9100	9380	9000	9680	8800
$/MYR	3.34	3.35	3.3	3.36	3.2	3.37	3.2
$/PHP	45.9	46.3	45.5	46.7	45	47.3	44.5
$/THB	32.7	32.7	33	32.7	32.8	32.8	32.8
$/INR	45.44	45.62	44	45.87	43.4	46.32	43
A$/$	0.91	0.9	0.95	0.89	0.95	0.87	0.9
$/¥	90.4	90.3	92	90.2	94	89.9	98
EUR/$	1.36	1.36	1.45	1.36	1.45	1.36	1.35

Source: GS Global ECS Research estimates.

Exhibit 48: The annual momentum of our Global Leading Indicator may start to turn down in Q2; this will be an issue for investors to monitor, because market returns have tended to be better when GLI momentum has been positive

GLI yoy growth vs. MXAPJ index levels, shaded areas = periods when yoy growth decelerated



Source: FactSet, MSCI, GS Global ECS Research.

Exhibit 49: Asia's external sector is recovering

Latest exports readings of Asian markets

	% yoy		% mom, s.a	
Country	**Latest**	**Previous**	**Latest**	**Previous**
China	45.7	21.0	61.8	7.2
Hong Kong	18.4	9.2	2.0	3.2
India	9.3	18.2	1.9	3.0
Indonesia	59.0	50.0	(4.8)	15.6
Korea	31.0	46.7	8.5	(6.6)
Malaysia	37.0	18.7	1.6	10.2
Philippines	23.8	5.7	(1.2)	5.9
Singapore	20.8	26.1	(8.9)	4.2
Taiwan	32.6	75.8	3.8	6.4
Thailand	30.8	26.1	0.9	13.1

Exhibit 50: Rising inflation pressures are prompting "early exits" from the accommodative policy settings of 2009

Latest CPI readings of Asian countries

	% yoy		% mom, s.a	
Country	**Latest**	**Previous**	**Latest**	**Previous**
China	1.5	1.9	(0.9)	6.3
Hong Kong	1.0	1.3	0.4	0.4
India	7.3	4.8	1.3	2.0
Indonesia	3.8	3.7	0.5	0.4
Korea	2.7	3.1	0.4	0.4
Malaysia	1.3	1.1	0.3	0.5
Philippines	4.2	4.3	0.9	0.0
Singapore	0.2	(0.5)	0.4	0.2
Taiwan	2.4	0.3	0.1	0.3
Thailand	3.7	4.1	0.2	0.6

Source: CEIC, GS Global ECS Research.

Earnings: Strong 2010 prospects

Our expectation of strong earnings growth is a core plank that underpins our positive strategic stance on regional equity markets. With the reporting season over halfway finished, we refresh our earnings analysis:

- **Reporting season tracking 105% of 2009 estimates:** At this writing, close to 60% of the MSCI Asia ex Japan constituents have reported results, and earnings are tracking 105% of full year 2009 estimates (Exhibit 55). Upside surprises have come from Korea and Singapore, and from the tech and consumer discretionary sectors. Looking ahead, HK/China results will be the focus for March and April, with financials largely dominating the pipeline (Exhibit 56-57).
- **Higher 2010 consensus earnings, with market and sector rotation:** Upward revisions have continued, but the leaders and laggards have changed. Korea's positive revision momentum has slowed after substantial upward adjustments during recent quarters. Australia, Hong Kong and Taiwan are the markets that have seen the best recent revisions, while transportation, mining and semiconductors are the sectors that have had the most pronounced earnings upgrades (Exhibits 51-54).
- **The gap between GS top-down vs. consensus has narrowed:** We update our 2010E top-down growth forecasts to account for higher 2009 base effects. We expect the region to grow profits by 30% vs. the updated consensus of 26% (Exhibit 58). The gap between our top-down estimated growth rates and consensus is now 4%, whereas it was 11% at the start of the year. We continue to expect over 20% profit growth in 2011 as margins normalize; consensus currently stands at 15%.
- **Putting our top-down forecast in context:** Margin recovery is the key argument for our strong earnings growth forecast – our current assumption for 2010E net margin (excluding banks and losses) is 9.9%, which compares to consensus of 8.9%. Relative to history, our current assumption is still well below the pre-2008 levels of over 11%. Although index constituent changes hamper historical analysis, net margins rebounded in a similarly swift manner to what we are currently forecasting after the global downturn in 2001-2002 (Exhibit 59).
- **Our above-consensus tech sector earnings are based on moderate assumptions:** We are most out-of-consensus with respect to our tech sector top-down estimates (116% 2010 earnings growth vs. consensus 83%), although here too the gap has narrowed substantially over the past few months. Compositionally, our numbers assume 20% sales growth and 7% net margins, which compare comfortably to the 15-25% sales growth range and 7-8% margin range during prior periods of benign macro conditions. Given the developed market PC replacement cycle and the waxing of emerging market demand for tech products, we feel our sales and margin expectations are reasonable and therefore continue to expect upward revisions to consensus estimates (Exhibit 60-63). In the near term, however, our tech analysts note that 2Q tends to be a seasonally slow period, so the momentum of consensus upgrades could moderate.
- **Stress-testing earnings:** To help investors gauge the risks around the earnings outlook, we have examined a few simple "stress" scenarios. For example, in a fairly harsh scenario where G3-exposed sectors (19% of regional earnings) continue to have sales growth and margins at 2009 levels and the tradable EM exposed sectors (22% of regional 2010E earnings) also show no margin improvement in 2010, the region could still deliver 15% earnings growth. At this level of earnings, the region would be trading at 14.9X 12M forward P/E level – just a bit above historical mean levels. Assuming consensus mid-teens earnings growth in 2011, this implies the region would be trading at 12.8x forward earnings by end-2010 (due to the time effect of accruing earnings). Our point is that it is hard to make a structural bear case for Asia with these valuations, even though markets would certainly come under pressure if earnings were to be revised down.

Exhibit 51: Consensus estimates for 2010 growth are now 26%
Evolution of consensus earnings growth estimates for MXAPJ index

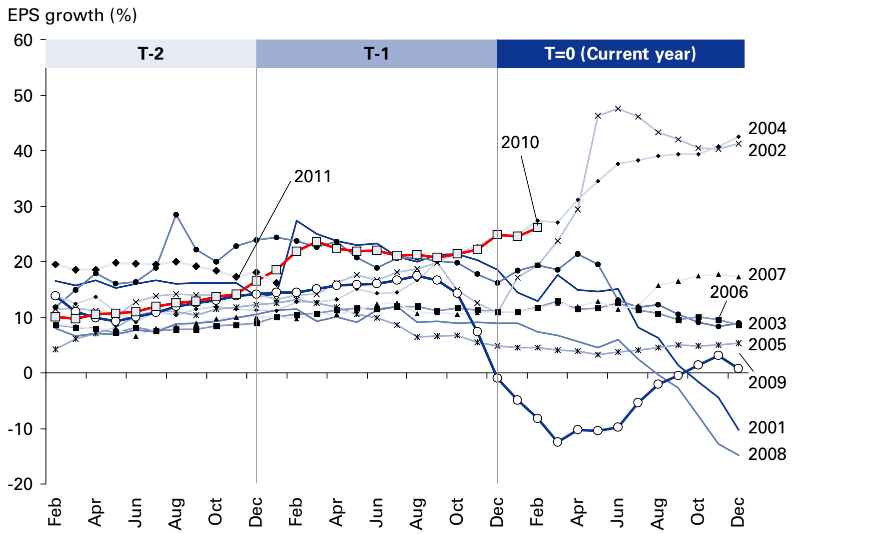


Exhibit 52: 2010E earnings have been revised up by 3% ytd
2009E and 2010E earnings estimates for MSCI AC Asia Pacific ex Japan index

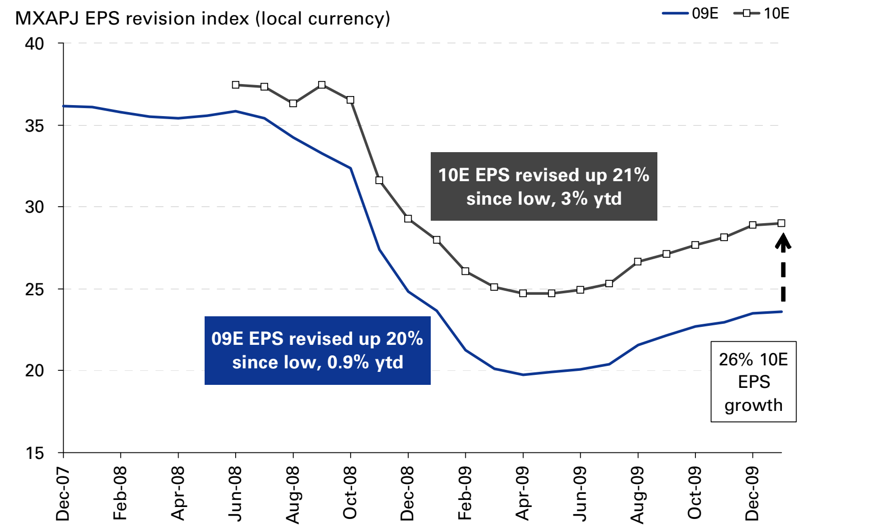


Exhibit 53: Korea's earnings revisions have recently slowed after early strong revisions; revisions in Australia, Hong Kong and Taiwan are now strongest
Change in earnings estimates by markets

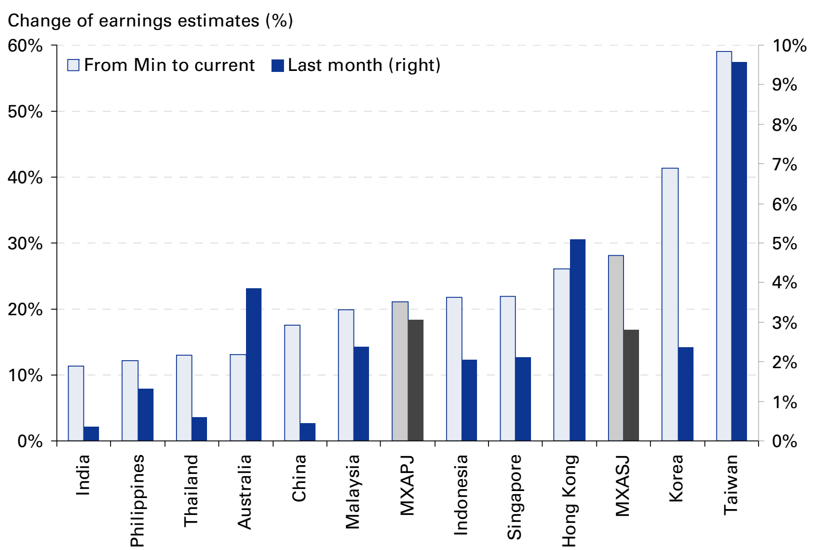
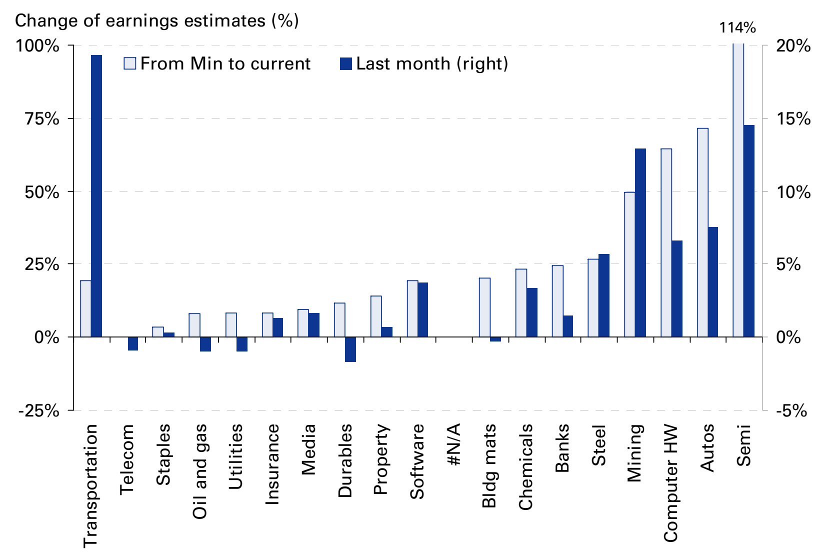


Exhibit 54: Transportation earnings upgrades have gathered pace; semiconductor and mining revisions are strong
Change in earnings estimates by GS sectors



Source: FactSet, I/B/E/S, MSCI, GS Global ECS Research estimates.

Exhibit 55: Asia ex Japan's reported earnings have been tracking 105% of full year estimates; Korea and Singapore posted upside surprises, as did consumer staples (autos, consumer electronics) and information technology

Summary of 2009Q4 earnings results – only markets and sectors with more than 50% index cap reported are shown, all on parent basis

	Reported Cos.		CY2H09		CY09	Actual vs. forecast
	# of Cos.	% of MSCI cap	Yoy (%)	Hoh (%)	Yoy (%)	CY09
MSCI markets						
India	58	99%	**12%**	**-1%**	**6%**	**98%**
Korea	91	97%	**513%**	**68%**	**69%**	**107%**
Malaysia	42	100%	**83%**	**26%**	**5%**	**102%**
Philippines	6	58%	**36%**	**-3%**	**17%**	**96%**
Singapore	29	100%	**7%**	**14%**	**-9%**	**107%**
Thailand	23	100%	**421%**	**-6%**	**24%**	**102%**
MXASJ	306	56%	**152%**	**60%**	**22%**	**105%**
MSCI AC Asia ex Japan sectors						
Materials	38	76%	**57%**	**86%**	**-6%**	**98%**
Information technology	40	71%	**NM**	**446%**	**84%**	**107%**
Industrials	64	65%	**66%**	**2%**	**9%**	**103%**
Energy	24	55%	**147%**	**-25%**	**24%**	**90%**
Consumer staples	27	78%	**3%**	**28%**	**-3%**	**108%**
Consumer discretionary	37	67%	**221%**	**39%**	**70%**	**113%**
Utilities	20	71%	**401%**	**35%**	**56%**	**103%**
Health care	9	96%	**153%**	**18%**	**80%**	**116%**

Source: FactSet, I/B/E/S, MSCI, GS Global ECS Research estimates.

Exhibit 56: HK/China will dominate the earnings season in the coming 2 months
Earnings calendar by market

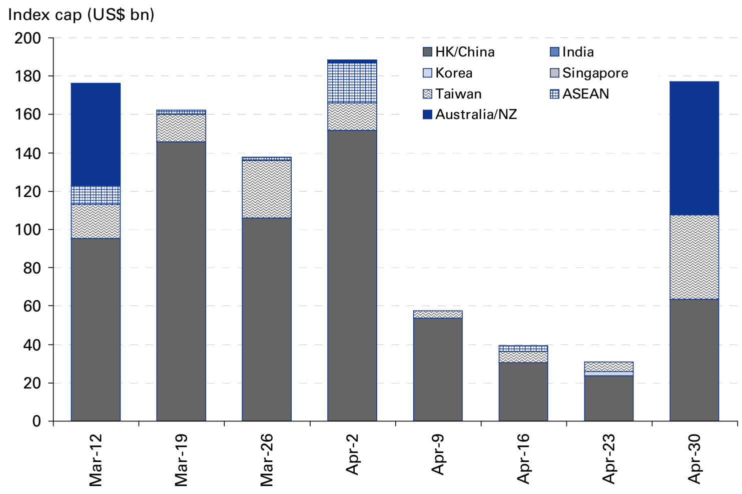
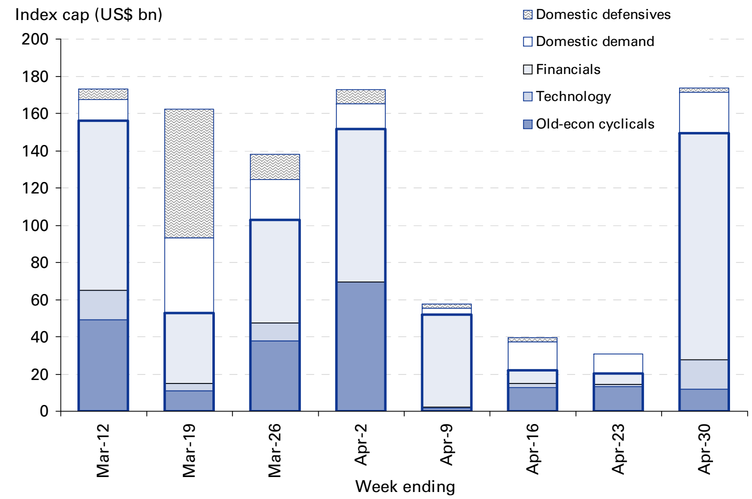


Exhibit 57: The bulk of financials report earnings in the next few weeks
Earnings calendar by sectors

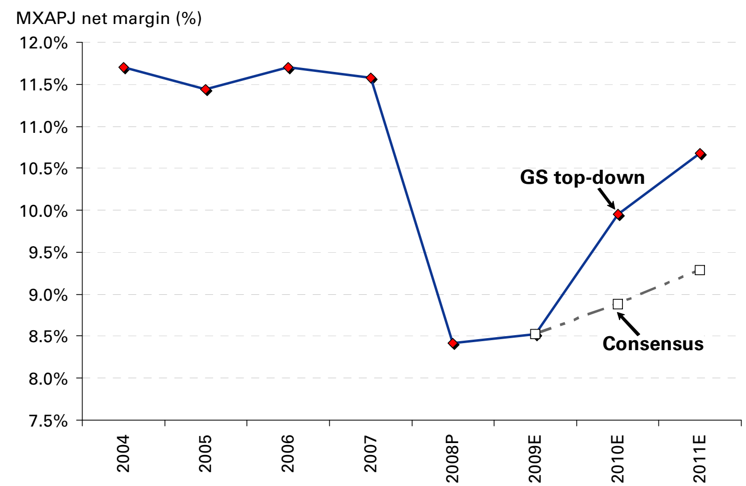


Source: Bloomberg, GS Global ECS Research estimates.

Exhibit 58: With a higher 2009 earnings base, our 2010 top-down earnings forecast now implies 30% growth; consensus expectations have risen to 26% growth, so the gap with our top-down numbers has narrowed
Earnings growth estimates by market

	Consensus			GS Top-down
	09E	10E	11E	10E
China	17%	23%	18%	**30%**
Taiwan	50%	80%	18%	**97%**
Korea	53%	39%	10%	**36%**
India	1%	23%	21%	**27%**
Hong Kong	4%	17%	9%	**16%**
Australia	-8%	12%	19%	**13%**
Singapore	-10%	16%	10%	**13%**
Indonesia	9%	15%	19%	**17%**
Malaysia	-7%	18%	13%	**18%**
Philippines	20%	17%	11%	**17%**
Thailand	20%	16%	17%	**16%**
MXAPJ	**9%**	**26%**	**15%**	**30%**

Exhibit 59: Net margin recovery is the key argument for our strong earnings growth forecast; our current assumption is still below the pre-2008 levels
MXAPJ net margin series (excluding banks and losses)



Source: Bloomberg, FactSet, I/B/E/S, MSCI, Worldscope, GS Global ECS Research estimates.

Exhibit 60: Non-G3 contributes most of tech shipment growth although the share of shipments is still G3-oriented
Share of 2010E global shipments and shipment growth

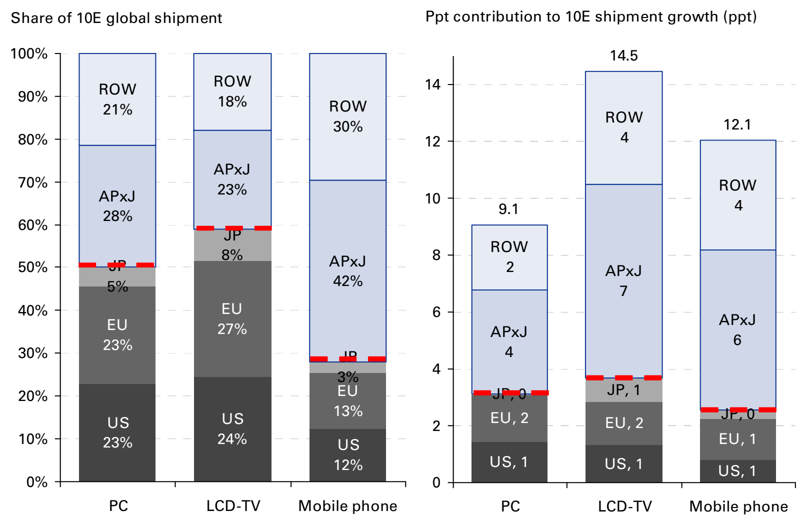


Exhibit 61: Tech net margins should recover due to erasing losses and utilization returning towards peak levels
Utilization levels vs. MXAPJ semi & hardware net margin

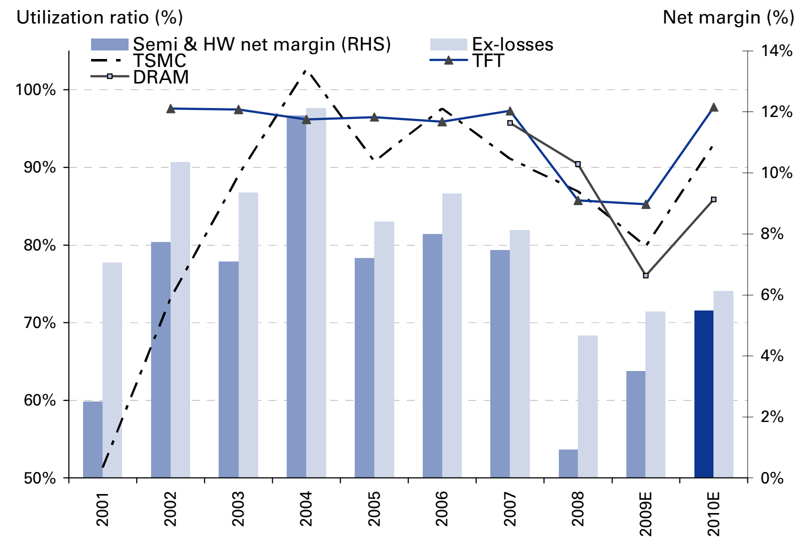


Exhibit 62: We expect normal levels of 2010 tech sector sales growth and net margins, driven by strong EM demand and DM replacement cycle

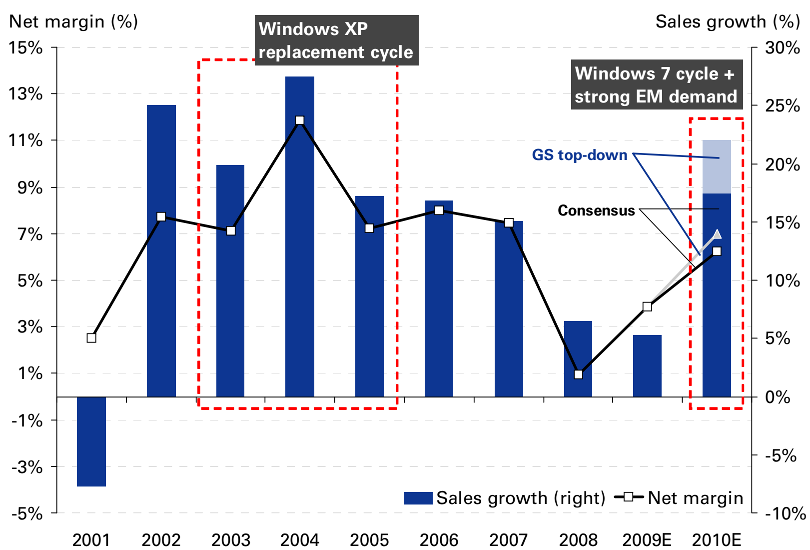
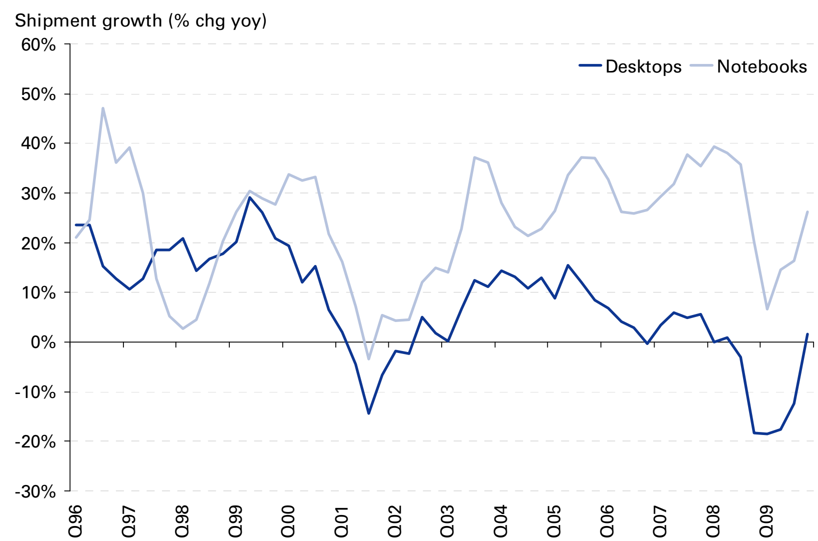


Exhibit 63: Our tech analysts expect the DM replacement cycle to occur in 2H10
Desktops and netbooks shipment growth series

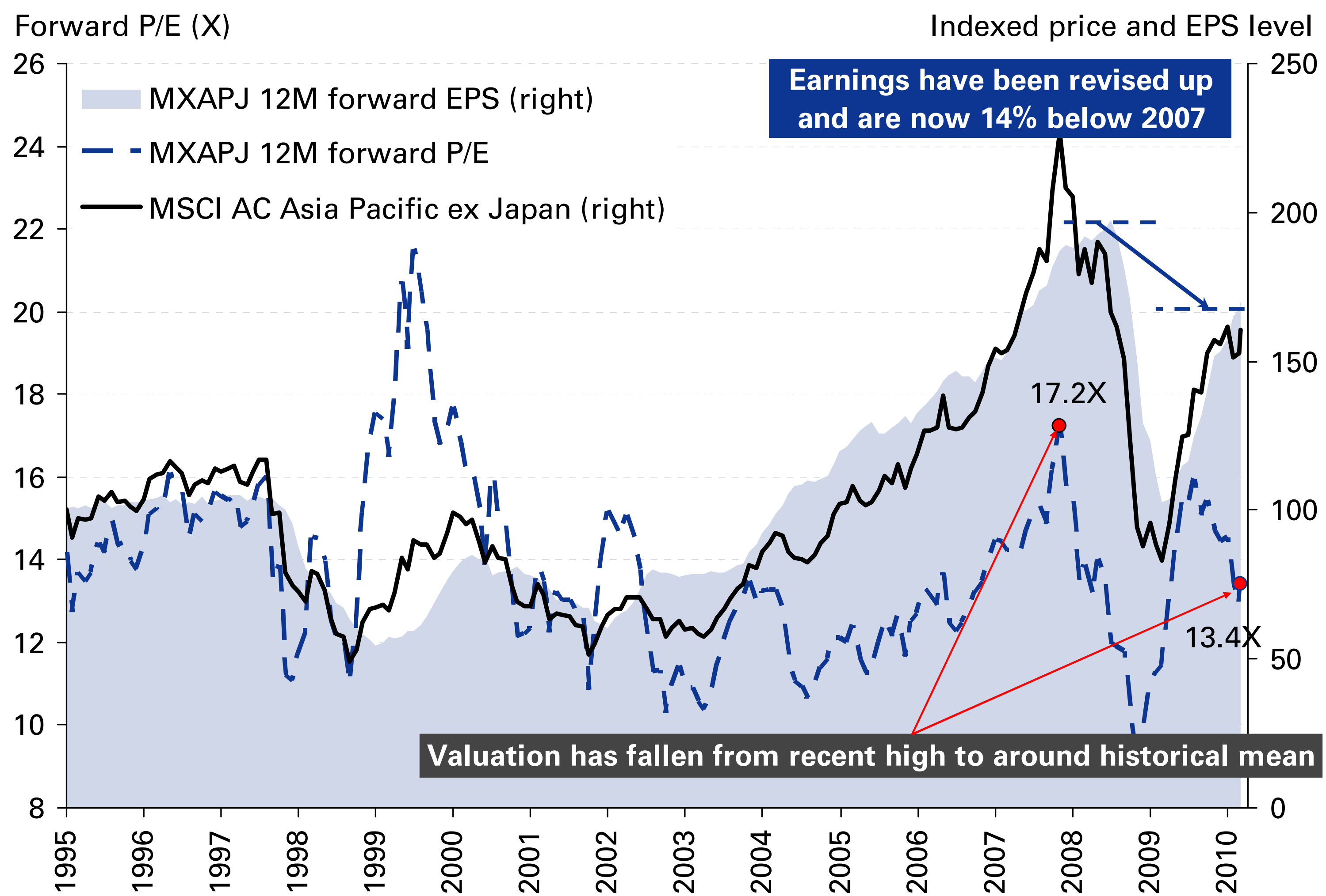


Source: Company data, IDC, FactSet, I/B/E/S, MSCI, Worldscope, GS Global ECS Research estimates.

Valuations

Exhibit 64: Earnings are recovering but valuations have recently fallen; we expect the earnings recovery to continue and believe valuation risk is low

MSCI AC Asia Pacific ex Japan index levels, 12M forward earnings, and P/E



Source: FactSet, I/B/E/S, MSCI, GS Global ECS Research estimates.

Exhibit 65: Regional forward P/Es have slipped back below the long-term mean
12M forward P/E of MSCI AC Asia Pacific ex Japan index

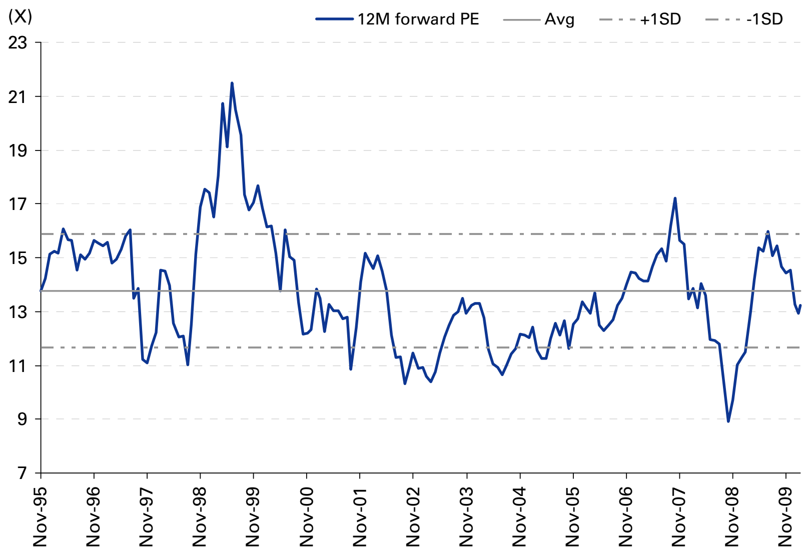


Exhibit 66: Regional price/book ratios are at average levels
12M trailing P/B of MSCI AC Asia Pacific ex Japan index

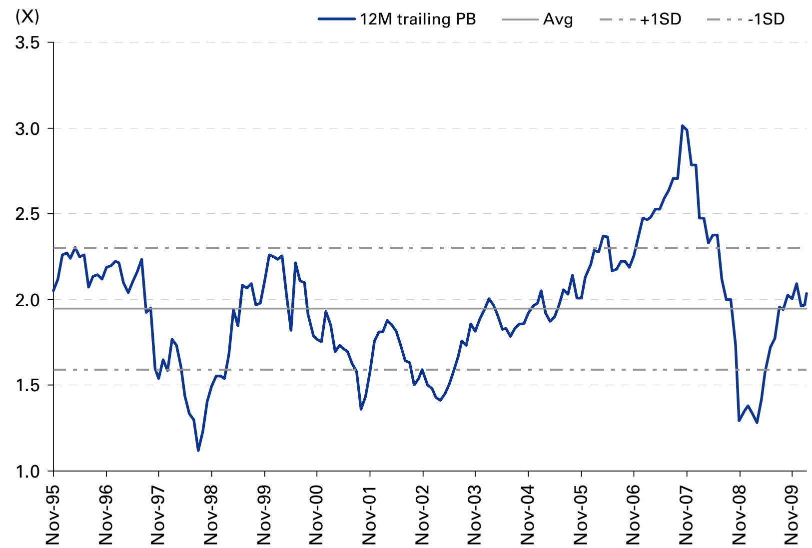


Exhibit 67: Most markets are at moderate valuations relative to their historical ranges

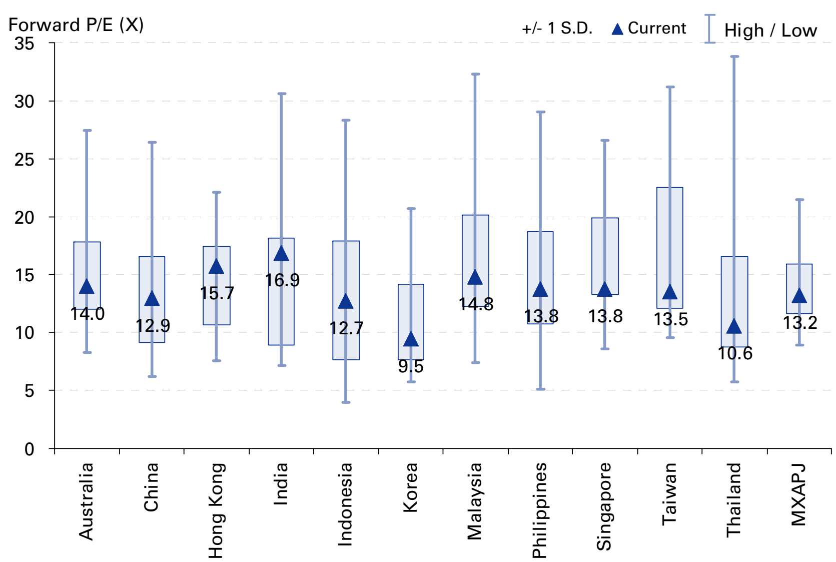
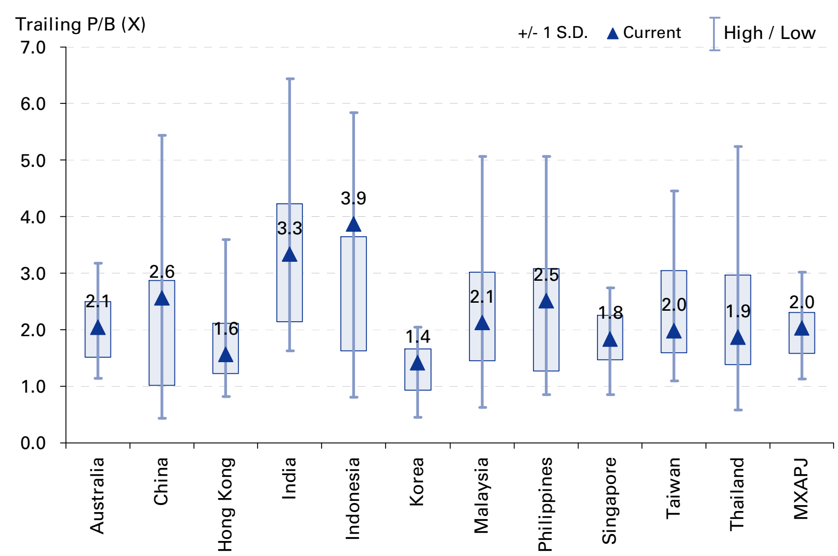


Exhibit 68: Price/book ratios are generally moderate relative to range, but are higher than P/Es are relative to their range because ROEs have risen



Source: FactSet, I/B/E/S, MSCI, GS Global ECS Research estimates

Exhibit 69: Profitability in Asia is rebounding as both asset turns and EBIT margins rise

ROAE disaggregation of MSCI AC Asia Pacific ex Japan (excluding financials)

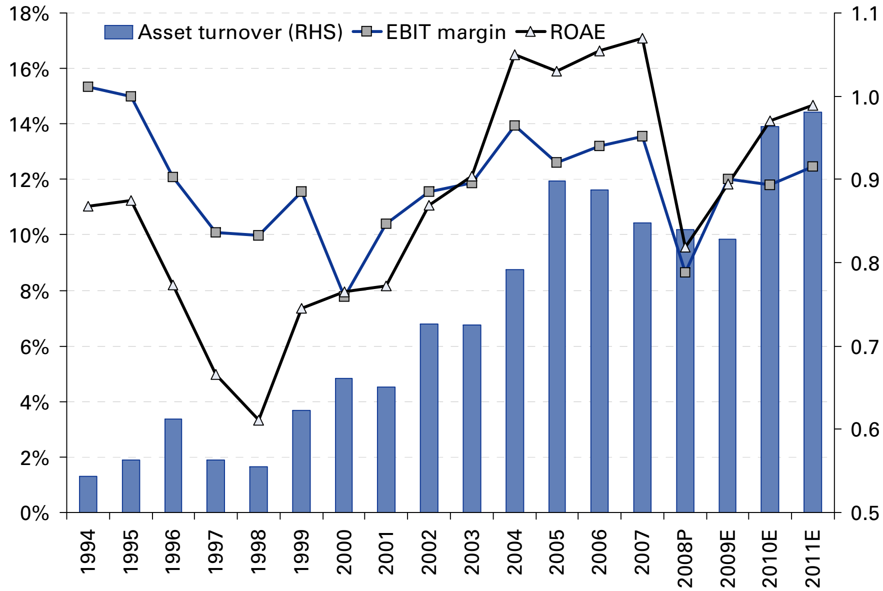
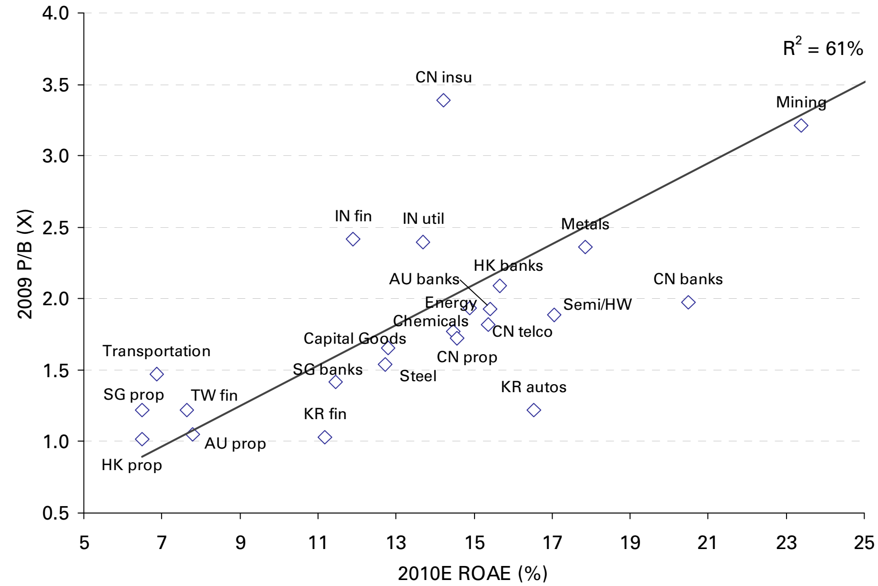


Exhibit 70: China banks stand out from a valuation/profitability perspective

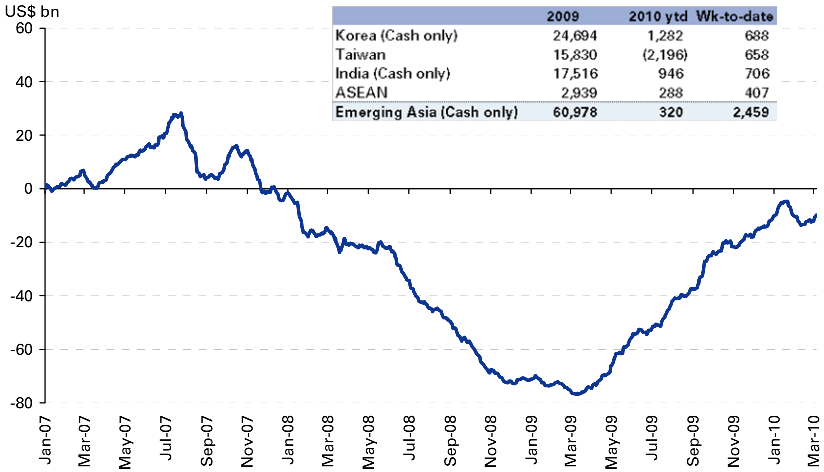
P/B vs. ROAE of "GS true sectors"



Source: FactSet, I/B/E/S, MSCI, GS Global ECS Research estimates.

Sentiment indicators

Exhibit 71: Foreign investors have rebought most of what they sold during the bear market
Cumulative net foreign fund flow since 2007



	2009	2010 ytd	Wk-to-date
Korea (Cash only)	24,694	1,282	688
Taiwan	15,830	(2,196)	658
India (Cash only)	17,516	946	706
ASEAN	2,939	288	407
Emerging Asia (Cash only)	**60,978**	**320**	**2,459**

Exhibit 72: Risk appetite has recovered from bear market lows but is fluctuating a lot so far this year
Goldman Sachs Equity Risk Barometer (GS-ERB)

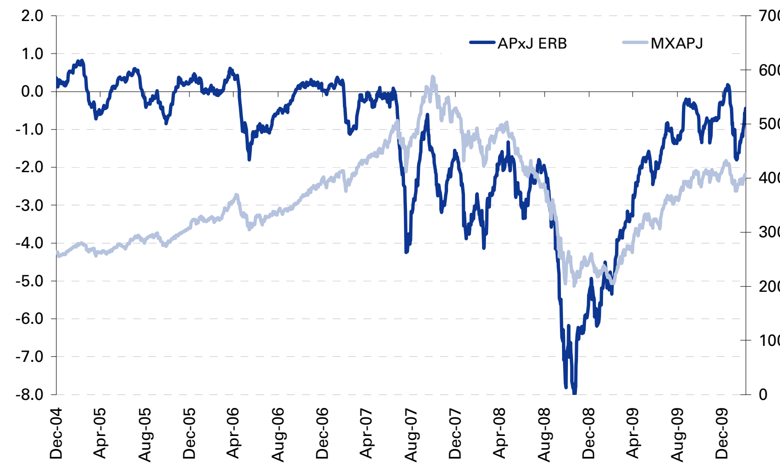


Exhibit 73: Market activity in Asia has been strong
Cash turnover on Asian exchanges

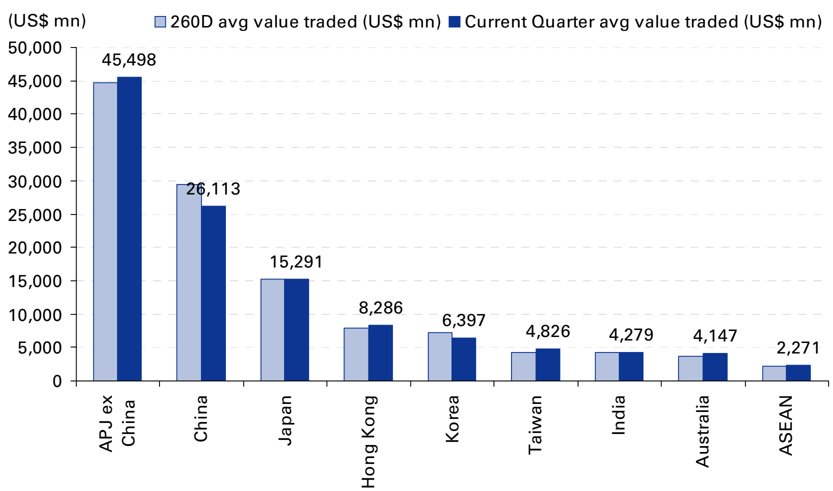
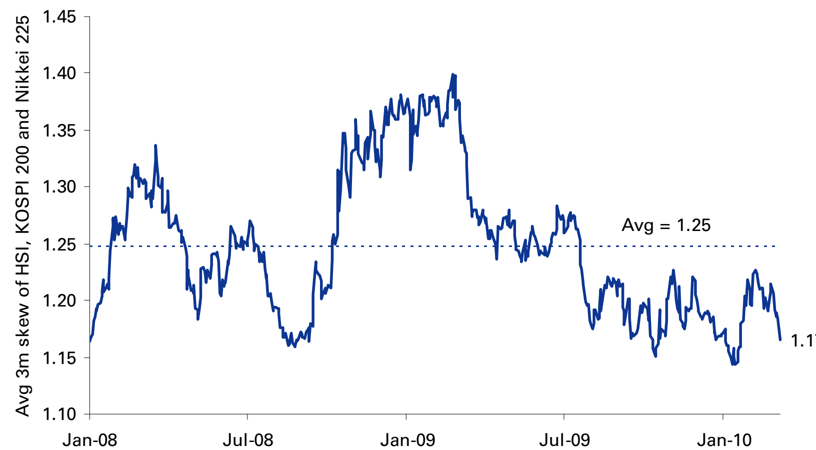


Exhibit 74: Following an early-year spike, skew is back down at low levels
Average 3-month skew of HSI, KOSPI 200 and Nikkei 225



Source: AMG, Bloomberg, local stock exchanges, GS Global ECS Research.

Implementation ideas

Exhibit 75: Buy-rated stocks that have attractive growth/valuation profiles and recently retreated in share prices

Bloomberg	Name	Market	GICS sector	Pricing currency	Price (Mar-25)	Rating	Listed cap (US$mn)	% change from Jan high	Upside/ downside to target price	P/E 2010E	P/B 2009	ROE 2010E	EPS gwth 2010E
						B/B*	>1,000	<-10%	>20%	<15		>10%	>10%
3333 HK	Evergrande Real Estate Group	China Offshore	Financials	HKD	3.28	B	6,338	-24%	27%	5.5	3.6	39%	632%
3339 HK	Lonking Holdings	China Offshore	Industrials	HKD	5	B	1,378	-22%	34%	10.3	2.9	22%	47%
006360 KS	GS Engineering & Construction	Korea	Industrials	KRW	89900	B*	4,020	-21%	56%	9.5	1.4	13%	26%
1777 HK	Fantasia Holding Group Co.	China Offshore	Financials	HKD	1.7	B*	1,067	-21%	54%	5.2	2.0	27%	33%
1898 HK	China Coal Energy (H)	China Offshore	Energy	HKD	12.62	B	6,676	-21%	51%	11.1	2.3	17%	71%
066570 KS	LG Electronics	Korea	Consumer Discretionary	KRW	104500	B*	13,252	-17%	31%	7.1	1.7	12%	16%
IFAR SP	Indofood Agri Resources	Singapore	Consumer Staples	SGD	2.11	B*	2,184	-17%	37%	11.8	2.2	11%	100%
1238 HK	Powerlong Real Estate Holdings	China Offshore	Financials	HKD	2.23	B	1,174	-16%	33%	5.9	1.1	15%	12%
1088 HK	China Shenhua Energy (H)	China Offshore	Energy	HKD	34.25	B	14,995	-16%	46%	12.2	3.5	23%	46%
005830 KS	Dongbu Insurance Co.	Korea	Financials	KRW	31950	B*	1,983	-16%	55%	6.8	1.4	19%	16%
LANCI IN	Lanco Infratech	India	Industrials	INR	48.8	B	2,576	-16%	23%	11.4	3.9	19%	106%
1171 HK	Yanzhou Coal Mining (H)	China Offshore	Energy	HKD	16.7	B*	4,213	-15%	62%	8.5	2.4	22%	109%
2498 TT	HTC Corp.	Taiwan	Information Technology	TWD	322.5	B*	7,971	-15%	31%	9.1	3.8	34%	22%
003550 KS	LG Corp.	Korea	Industrials	KRW	63100	B	9,546	-15%	36%	5.7	1.4	20%	18%
3231 TT	Wistron	Taiwan	Information Technology	TWD	56.3	B	3,288	-15%	26%	9.6	1.9	19%	15%
000660 KS	Hynix Semiconductor	Korea	Information Technology	KRW	22500	B	11,632	-14%	34%	6.0	2.3	26%	667%
2301 TT	Lite-On Technology	Taiwan	Information Technology	TWD	41.95	B	2,973	-14%	24%	10.5	1.5	13%	29%
005490 KS	POSCO	Korea	Materials	KRW	545000	B*	41,659	-13%	29%	12.1	1.5	12%	34%
2317 TT	Hon Hai Precision	Taiwan	Information Technology	TWD	134	B	36,017	-12%	31%	13.0	2.5	15%	30%
3818 HK	China Dongxiang Group	China Offshore	Consumer Discretionary	HKD	5.35	B*	3,905	-12%	35%	14.9	3.5	20%	22%
BBRI IJ	Bank Rakyat Indonesia	Indonesia	Financials	IDR	7250	B	9,587	-12%	31%	9.7	3.3	28%	34%
270 HK	Guangdong Investment	China Offshore	Utilities	HKD	4.06	B	3,250	-12%	23%	11.1	1.5	11%	10%
5 HK	HSBC Holdings	Hong Kong	Financials	HKD	81.8	B*	183,593	-11%	49%	13.5	1.5	11%	55%
1398 HK	ICBC (H)	China Offshore	Financials	HKD	5.8	B	62,056	-11%	21%	10.0	2.5	23%	36%
UOB SP	United Overseas Bank	Singapore	Financials	SGD	17.86	B	19,462	-10%	31%	12.4	1.6	12%	22%
UNTP IN	United Phosphorus	India	Materials	INR	164.25	B	1,581	-10%	21%	10.8	2.4	19%	28%

* On our Regional Conviction List

Source: Goldman Sachs Research estimates, Gao Hua Securities Research estimates.

Exhibit 76: Valuation summary of our ATV trades

Ticker	Stock name	6M GSLE (US$mn)	CY10E P/E (X)	CY11E P/E (X)	CY10E EPS gwth (%)	CY11E EPS gwth (%)	CY10E P/B (X)	CY10E D/Y (%)	CY10E ROE (%)
2498 TT	HTC Corp.	69.0	9.6	8.3	21.9	15.9	3.3	7.6	34.3
9432 JP	Nippon Telegraph & Telephone	92.0	10.0	9.5	4.4	5.4	0.7	3.2	6.6
4042 JP	Tosoh (short)	12.2	NM	66.3	15.9	122.9	1.0	1.6	NM
GSCNBANK	China Banks	563.3	9.2	7.5	32.0	22.7	1.9	5.0	20.7
5411 JP	JFE (vs. Topix)	111.6	9.9	7.4	180.9	34.2	1.3	2.0	13.0

Note: The names and baskets above are long positions except Tosoh (which is a short).

Source: Goldmnan Sachs Research estimates.

Current Asia Trading Views (ATV) recommendations

Exhibit 77: Long China banks basket (GSCNBANK)
Initiated date: March 5, 2010

- **Significant underperformance, attractively-valued:** From their mid-November high, China banks have fallen almost 20%, underperforming the market by 10ppt. The sector is now trading at 9.6X 2010E P/E and 2.2X 2009 P/B, towards the low end of historical ranges. On a P/B vs. ROE basis, China banks look very attractive relative to other China sectors.

- **Light positioning in a large cap sector:** China banks are the largest sector in the offshore China indices (currently 22% in MXCN) and the second largest country-sector in the MSCI Asia ex Japan index (6% of MXASJ).

- **Strong earnings growth:** Our China banks analyst forecasts 32% 2010E EPS growth vs. consensus 22% – we believe earnings surprises are to the upside, and banks are likely to benefit from rate hikes

- **Thus, risk-reward looks attractive here and we would prefer to be early in establishing positions even with uncertain news flow in the weeks ahead.**

Exhibit 78: CN banks: most attractively valued and largest investable sector
Data as of March 4, 2010

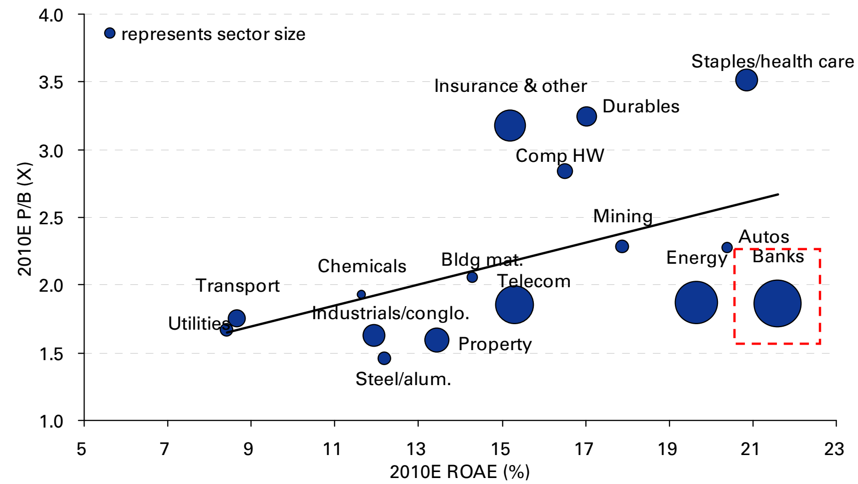


Exhibit 79: Long JFE Holdings (5411 JP) vs. TOPIX
Initiated date: March 5, 2010

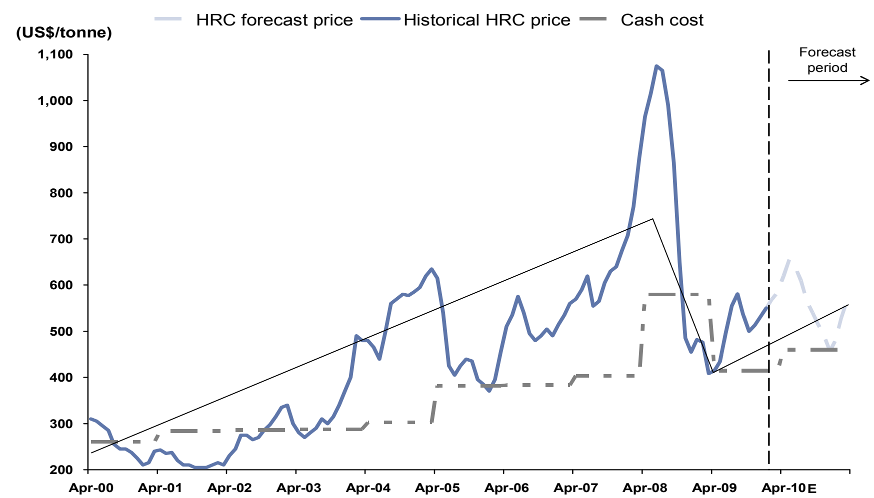
- **Spot steel price have been rising since Chinese New Year:** Tokyo Steel, China Steel, and Baosteel have already announced price hikes. Bloomberg has reported that JFE plans to raise prices by as much as $200/t starting in April, which we view as an indication of the level of price rise they are considering.

- **Strong underlying demand:** Strong underlying demand, the advent of greater raw materials costs, and impending shortages, which would all push steel prices higher, have steel buyers worried, despite increases in inventory which implies that steel consumers are bringing demand forward. Cash costs are expected to rise this year, driving further upside in steel prices.

- **Attractive valuation:** JFE, a major exporter to the region, is trading near trough P/E multiple (12x 2010E P/E) based on GS earnings estimates.

- **We suggest long JFE shares and recommend a 100% TOPIX hedge to isolate the alpha component.**

Exhibit 80: We expects cash cost to rise again this week, pushing up prices
Trend of HRC price and cash costs



Source: FactSet, I/B/E/S, GS Global ECS Research estimates.

Exhibit 81: Long HTC (2498 TT)
Initiated date: February 26, 2010

- **Attractive valuation:** HTC is currently trading at 8.9X 12M forward P/E (near its 2007 trough) and 3.1X 12M forward P/B (near a 5-year low). These levels appear attractive given our analyst's forecast of 22% EPS growth in 2010 (vs. 11% decline for consensus).

- **Margin recovery:** our analyst forecasts operating margin to trough in 1Q2010 and rise to 18% by 4Q2010. We believe the margin recovery could surprise market on the upside.

- **New operator partnership:** Vodafone, Telstra and O2 have all recently announced the adoption of HTC's newly launched products. HTC has indicated that a "record-high" number of operators will be selling their devices.

- **Significant pick-up in monthly sales:** HTC's new products will be broadly available in Europe/Asia in early Q2. Our analyst expects monthly sales to pick up significantly (as soon as March)

Exhibit 82: HTC's operating margin is likely to trough in 1Q2010
HTC's operating margin and GS forecasts

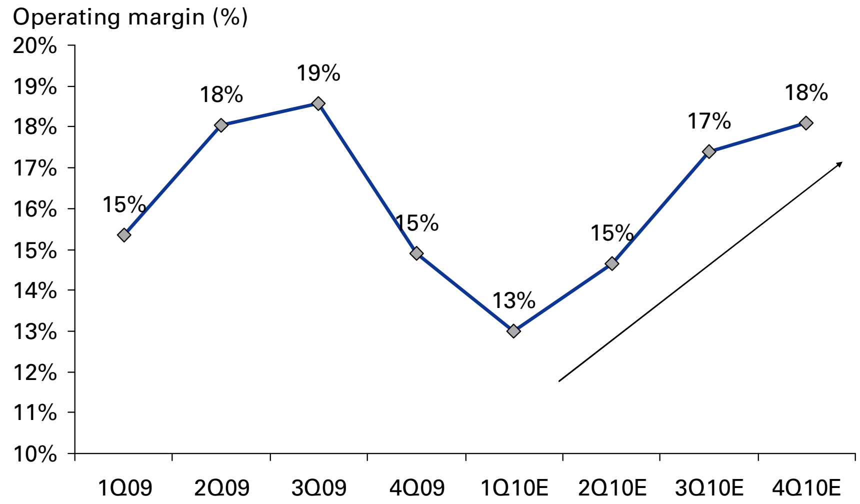


Exhibit 83: Long NTT (9432 JP): new business plan could be a catalyst to drive earnings upside
Initiated date: February 26, 2010

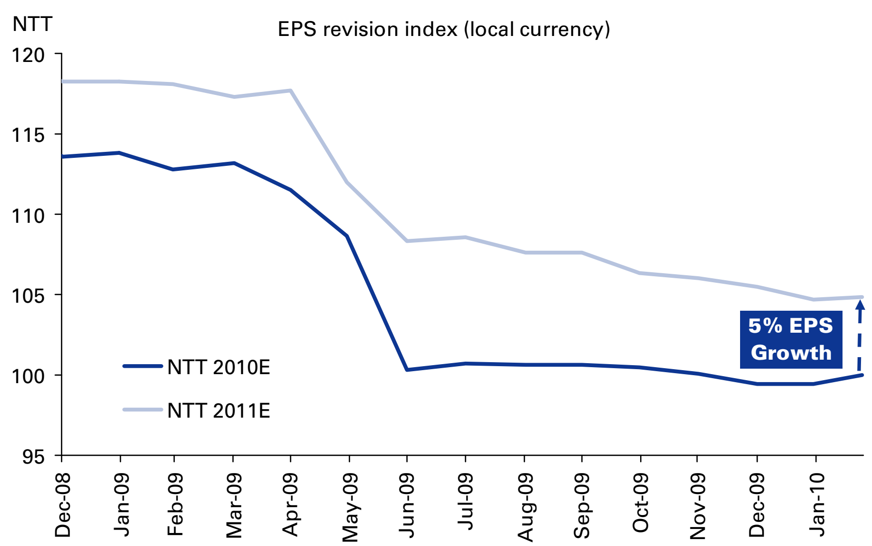
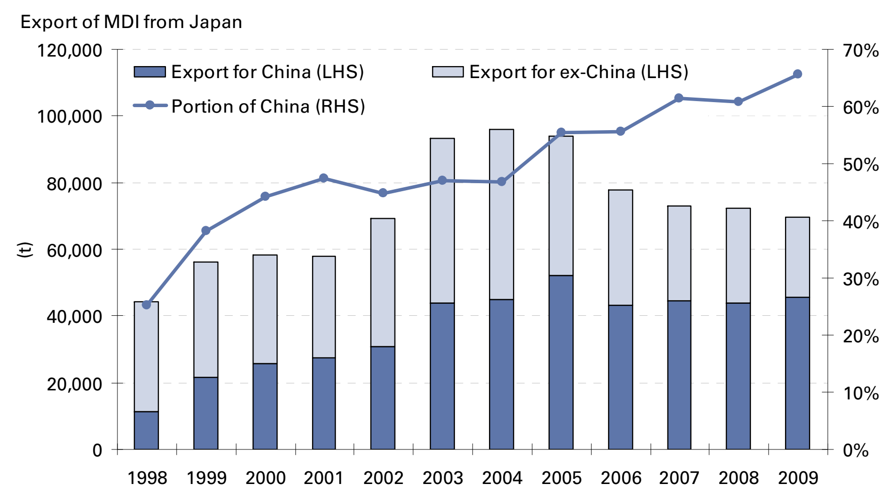


Exhibit 84: Short Tosoh (4042 JP): our analyst's FY2011 operating profit estimate is half of the consensus level
Initiated date: February 26, 2010



Sources: Company data, FactSet, I/B/E/S, GS Global ECS Research estimates.

Derivatives implementations

We believe options are increasingly attractive vehicles for directional exposure, as implied volatility fell sharply across the region year-to-date, despite markets trading lower. Currently, options across indices and tenors have lower implied volatility than at any point since 2007.

Use calls on HSCEI and NIFTY for upside exposure to those markets. NIFTY implied volatility has been pushed lower by increased option selling activity among Indian institutions. Implied volatility is now just two points above both Nikkei 225 and KOSPI 200 implied vol and in line with HSI implied vol, the low end of the ranges. We like using NIFTY options as opposed to futures for exposure given our positive fundamental view of the market and the potential for a continued rally following the recent budget announcement, coupled with the high valuations. Skew is high on NIFTY relative to other indices in the region, making call prices particularly attractive. 2-mo 105% calls cost 1.4%.

On HSCEI, rising China inflation has historically led to rising volatility as uncertainties increase over how the authorities will combat inflation, making options attractive as we head into a higher inflation period. Our economists forecast that inflation will rise from the recent print of 1.5% to 4.3% in July. In 2003-04, inflation above 4% led to downside volatility as the market reacted negatively to administrative measures to cool the economy. In 2007-08, when inflation spiked, it led to upside volatility as negative real interest rates pushed investors into stocks. We see HSCEI 2-mo 105% calls for 2.5% as an attractive, limited loss way to build a position in the market. Please see Exhibit 85 for indicative 2-mo 95% put and 2-mo 105% call prices across the region. We also expect incremental volatility surrounding potential CNY appreciation. USD/CNY 3m implied vol has spiked over the past 2 months while HSCEI implied vol fell along with other regional indices (Exhibit 87). Please see our February 1 report: *Long China vol strategies as inflation comes into focus*.

Upside trades we continue to like for directional exposure

1. Take advantage of the upside trade in Korea, low KOSPI volatility, and increasing stability of the KRW by selling puts on MSCI Korea (EWY US) to fund calls on KOSPI 200. Selling a 6-mo 88% put on EWY US fully funds a 6-mo 105% call on KOSPI 200. This trade, which we recommended in January, has traded relatively flat over the past quarter, but remains an attractive way to get long Korea while taking advantage of the higher implied volatility of the US-listed, USD-denominated EWY. The trade takes advantage of **(1)** a positive outlook for Korean equities; **(2)** Our view of slight KRW upside in the medium term; and **(3)** Lower KRW vs. KOSPI 200 correlation; we expect the KRW to no longer trade as a highly correlated risk asset as it did through most of 2008-09. Please see our January 25, 2010 report, *Combining Korea equity/FX/vol views: Sell MSCI Korea (EWY) puts to fund KOSPI 200 calls*.

2. Use the low TWSE forward to get long double the upside vs the downside risk via TWSE levered risk-reversals. TWSE is the only market globally where selling a 1-year 95% put more fully funds more than 2x 1-year 104% calls. This is because the TWSE offshore forward is pricing in 5.8% depreciation in the index over the coming year due to the 3.0% dividend yield and the 3.3% appreciation priced into the TWD vs. USD non-deliverable forward, creating an implicit negative interest rate of 2.8%. By comparison, selling a 1-year 95% put on Bovespa fully funds 2x 137% calls, 33 percentage points higher than the calls afforded by selling a 1-year 95% put on TWSE. Buyers of risk reversals risk unlimited loss of the TWSE price less the strike price. Taiwan remains one of our preferred markets, particularly for investors with a longer-term investment horizon. For more details on this trade, please see our January 14, 2010 report: *Ten Trades for 2010*.

Exhibit 85: We find NIFTY and HSCEI options relatively attractive
Cost of 2-mo 95% puts and 2-mo 105% calls; data as of March 8, 2010

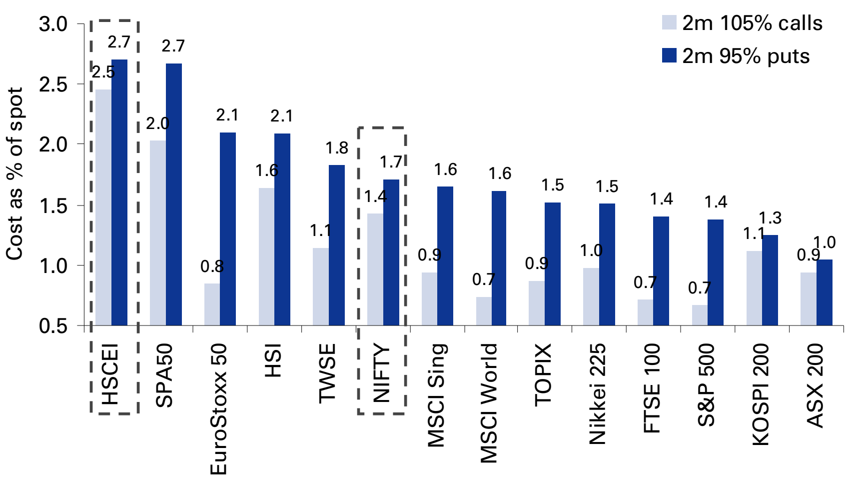


Exhibit 86: Increased NIFTY option selling strategies have depressed vol
NIFTY open interest

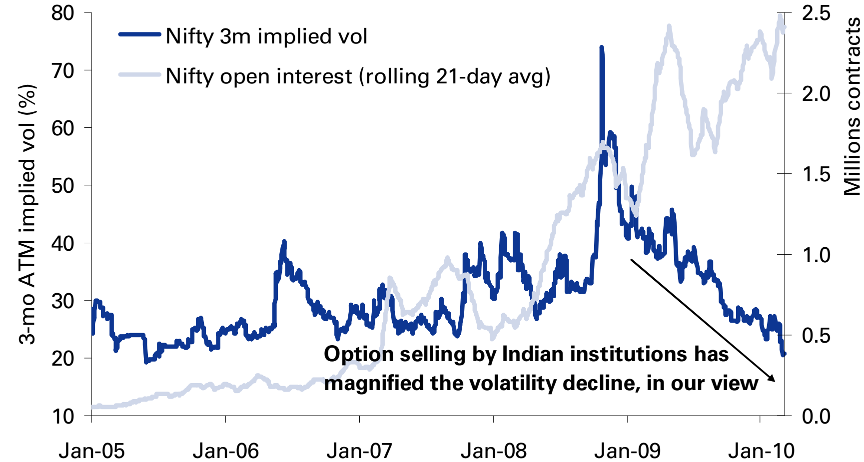


Exhibit 87: USD/CNY vol remains elevated vs. HSCEI
3-month ATM implied vol; data as of March 8, 2010

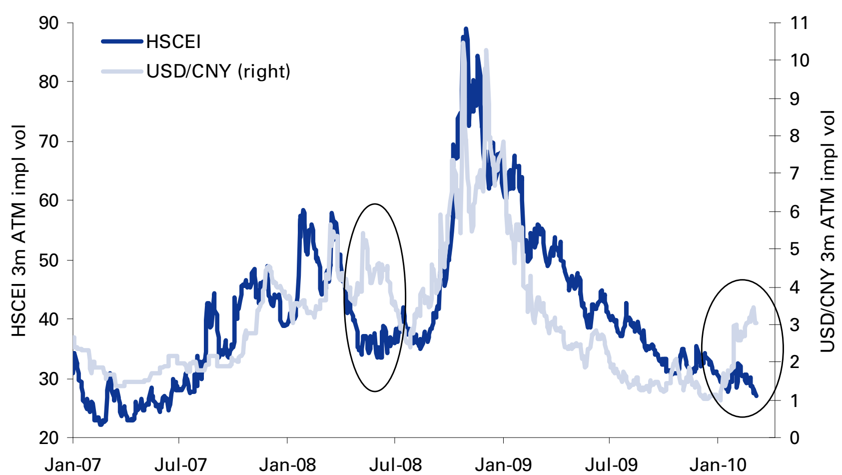
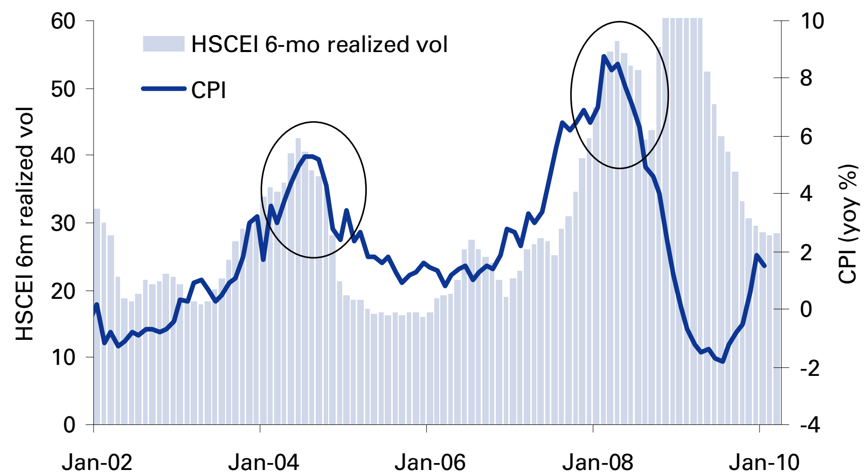


Exhibit 88: HSCEI has been volatile when China CPI above 3%
Data as of March 8, 2010



Source: Bloomberg, CEIC, GS Global ECS Research.

Exhibit 89: KRW strength has helped buffer EWY downside in 2010
Year-to-date performance; data as of March 8, 2010

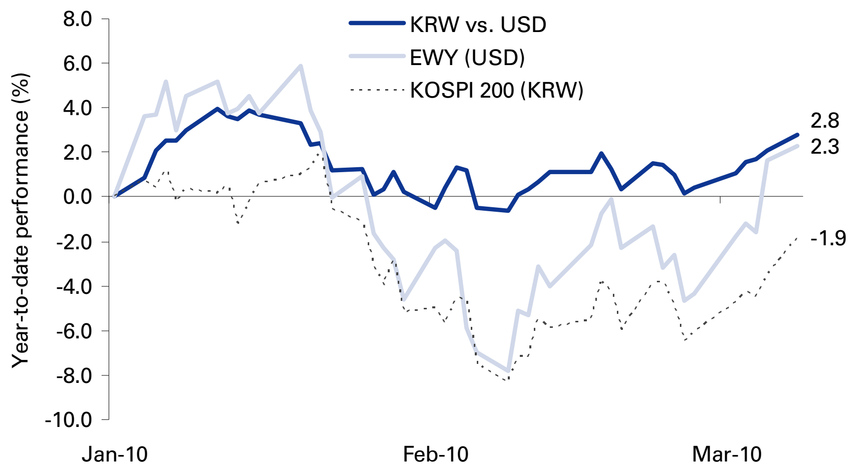


Exhibit 90: EWY put vol remains elevated vs. KOSPI 200 call vol
6-month implied vol of EWY and KOSPI 200; data as of March 8, 2010

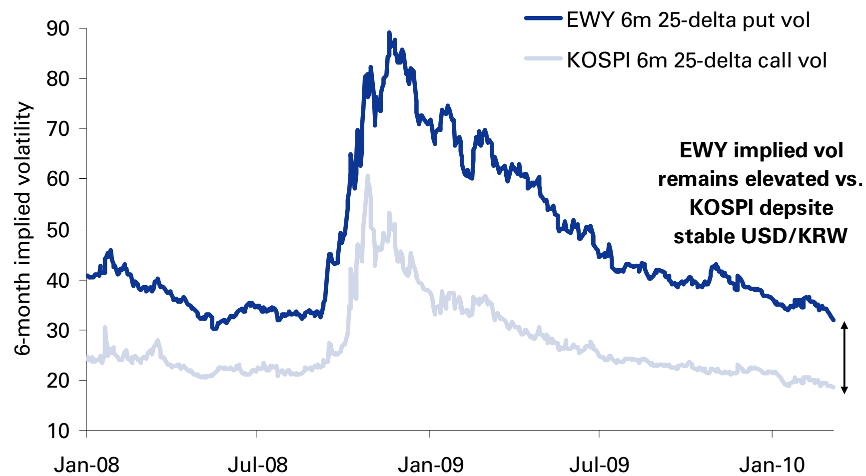


Exhibit 91: Selling TWSE 1-year 95% puts fully funds 2x 104% calls
Selling a 1-year 95% put fund can fully fund 2x the following calls

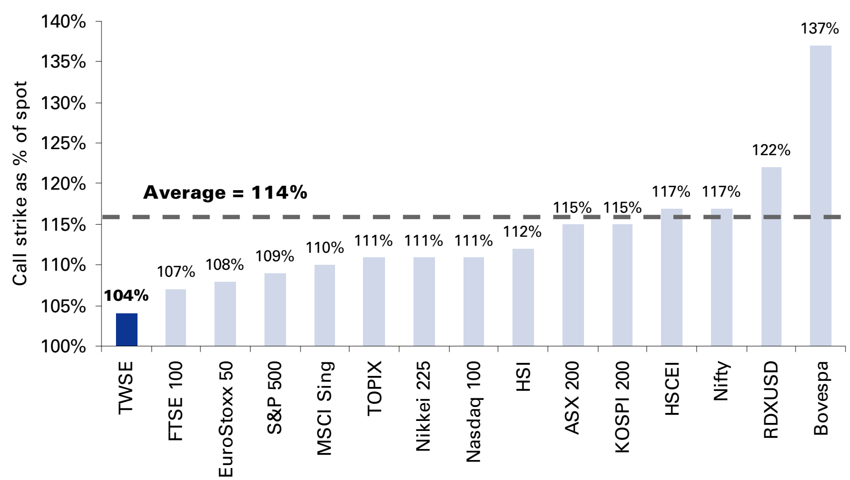


Exhibit 92: Backtest on TWSE 95/104% 1x2 risk reversals
Data as of March 8, 2010

Source: GS Global ECS Research.

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