Third Quarter 2010

Equity Strategy
Pan-Asia

HSBC Global Research

Asia Insights Quarterly

Stuck in a rut

- **With earnings forecasts being cut and PMIs falling, it's hard to make a case for Asian equities to boom over coming months**
- **But the long-term story remains good, so it would be a mistake to be too bearish**
- **Our favourite markets are Korea and Indonesia and we raise Australia to overweight. We like cyclicals, but cut IT to neutral**

Asian markets have been stuck in a trading range for almost a year: MSCI Asia ex Japan is up only 6% since the end of July 2009. We think the sideways market is likely to persist for a while yet. With earnings forecasts being revised down, PMIs falling from their cycle highs, liquidity drying up and lots of new issuance, especially in China and India, it's hard to see a reason why Asian equities should boom over the coming months. And, while valuations are cheap, they are not as super-cheap as in some other markets. Asia ex Japan is on a forward PE of 11.8x, but that is not so far below the average since 2001 of 12.5x and much more expensive than Russia (5x) or Brazil (9x).

Not that we are bearish. Asia's long-term story remains attractive. Growth in China, India and other Asian economies is likely to remain well above that in developed economies for years to come, with fewer structural risks. In the near term, our economists do not foresee a double dip. As long as earnings growth comes through, Asian stocks can continue to rise steadily. We forecast 8% upside in regional indexes to year-end, and recommend a neutral weighting versus a global benchmark.

Our country allocations focus on long-term growth stories with reasonable valuations. We continue to think Korea offers the best risk/reward trade-off in Asia: investors pay the lowest price of 8.9x forward PE for above-average EPS growth in 2010 of 49%. Indonesia's structural story and high ROE make it attractive, too. We raise Australia to overweight as a cheap, lower risk way of gaining exposure to China. We cut Japan to underweight as it will suffer from cyclical softness and a strong yen. We are neutral on China, and cut MSCI Hong Kong to neutral, too, since excess liquidity is drying up. Our biggest underweight remains India, which is expensive and has the biggest inflation risk.

Our sector recommendations remain pro-cyclical and have an above-market beta. Our focus is on long-term growth stories, such as industrials, which will benefit from a growing capex story in Asia, consumer discretionary and materials. Our only change this quarter is to cut IT to neutral from underweight. Demand for tech is still strong, but additional capex will increase supply, and earnings expectations have run ahead.

Garry Evans*
Strategist
The Hongkong and Shanghai Banking Corporation Limited
+852 2996 6916
garryevans@hsbc.com.hk

Steven Sun*
Strategist
The Hongkong and Shanghai Banking Corporation Limited
+852 2822 4298
stevensun@hsbc.com.hk

Vivek Misra*
Strategist
HSBC Bank plc
+91 80 3001 3699
vivekmisra@hsbc.co.in

Jacqueline Tse*
Strategist
The Hongkong and Shanghai Banking Corporation Limited
+852 2996 6602
jacquelinetse@hsbc.com.hk

HSBC strategy recommendations

Market recommendations

Market	HSBC recommendation	Previously	Rel 3M performance	End-2010 target	Current Index	Up/downside from current level
Japan	Under	Neutral	1.3%	900	837	7.5%
Australia	Over	Neutral	-10.5%	5,000	4,222	18.4%
China	Neutral	Neutral	1.7%	65	58	11.2%
Korea	Over	Over	-0.9%	2,000	1,675	19.4%
Taiwan	Neutral	Neutral	2.4%	8,000	7,440	7.5%
Hong Kong	Neutral	Over	3.1%	22,000	19,842	10.9%
India	Under	Under	3.5%	18,000	17,441	3.2%
Singapore	Neutral	Neutral	8.0%	3,000	2,844	5.5%
Malaysia	Under	Under	8.8%	1,300	1,300	0.0%
Indonesia	Over	Over	8.6%	3,200	2,877	11.2%
Thailand	Under	Under	6.4%	800	804	-0.5%
Philippines	Under	Under	10.4%	3,300	3,312	-0.4%

Source: HSBC, Note: Current Index and Rel 3M Performance as of 5 July 2010

Sector recommendations

Sector	HSBC recommendation	Previously	3m Performance	Market Overweight	Market Underweight
Financials	Neutral	Neutral	-1.6%	TW,IN	HK
Industrials	Over	Over	-0.1%	IN,TW,KR,CH	
IT	Neutral	Over	-2.4%	KR	
Consumer discretionary	Over	Over	-0.3%	TW	
Materials	Over	Over	-6.1%		IN
Telecoms	Neutral	Neutral	12.2%	HK	CH,TW,IN
Consumer staples	Under	Under	5.3%	TW	
Utilities	Under	Under	13.3%	HK	CH
Energy	Neutral	Neutral	-0.3%	CH	
Healthcare	Under	Under	6.0%		

Source: HSBC, Note: Current Index and Rel 3M Performance as of 5 July 2010

We acknowledge the contribution of Devendra Joshi, an associate in our Bangalore office, to the production of this report.

Contents

Investment strategy

- Asian equity markets have gone nowhere for the past 11 months
- With earnings forecasts softening, lead indicators turning down and valuations not dramatically cheap, we think this period of drift is likely to continue
- Asia's long-term story remains a good one, but we don't see any catalyst for a big market rebound over the next few quarters

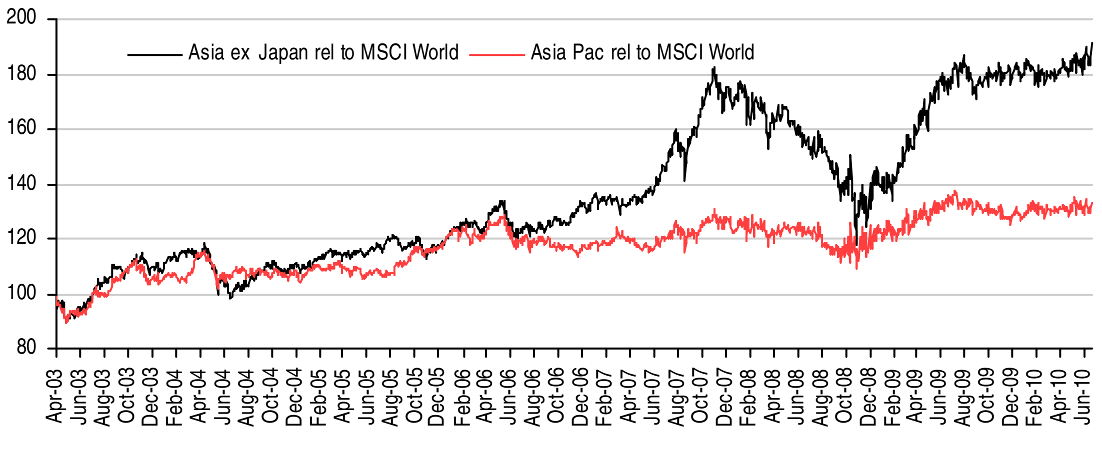
Stuck in a rut

The title of our Asia Strategy Quarterly exactly one year ago, in Q3 2009, was *Treading water*. We argued that, after a strong run, Asian equities were "likely to stutter over the next few quarters".

Depressingly, that has proved about right. Asian markets had a final run up in July last year and, since then, have largely been caught in a trading range (see Chart 2, overleaf). The MSCI Asia ex Japan Index at the end of June 2010 was only 6% above its level 11 months earlier.

And, sadly, we think that Asian equities are likely to stay stuck in this rut for some time longer. The fundamentals are showing the sort of softness typical of the second year of a rebound. Earnings forecasts are no longer being revised up (and, in a few instances, are seeing the first downgrades). Leading indicators such as the HSBC Asian Purchasing Managers Indexes (PMIs) have turned down, although they remain above 50 – meaning that economic expansion continues but at a slower pace. Asian markets remain vulnerable to risk aversion in the rest of the world: a total of

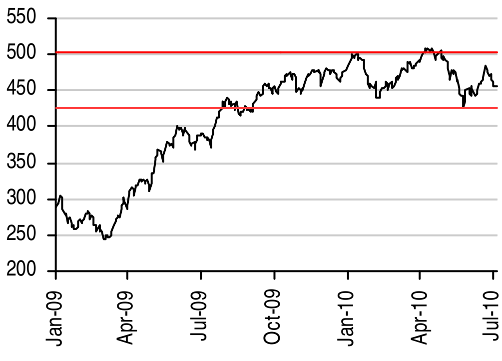
1. MSCI Asia-Pacific and MSCI Asia ex Japan (in dollars) vs MSCI World



Source: HSBC, Bloomberg

USD10bn was pulled out of Asia ex Japan equities in May and June, for example, when international investors were fretting about European sovereign debt.

2. MSCI Asia ex Japan since January 2009



Source: Bloomberg

And, while Asian valuations are cheap relative to their history – forward PE is 11.8x versus a long-term average of 14.4x –they are not as dramatically cheap as some other emerging markets (compare Russia's 5x or Brazil's 9x) or even the US and Europe.

We don't doubt that Asia's long-term story remains attractive. Growth in China, India and other Asian economies is likely to remain well above that in developed economies for years to come. Structural risks are also fewer: Asia generally has sound banking systems and Asian governments healthy fiscal positions. Nor do we expect a global recession, which would hurt high-beta and export-sensitive Asian markets. Our economists, for example, do not foresee a double dip (see HSBC's Asian Economics Quarterly, *The releveraging of Asia*, 7 July 2010).

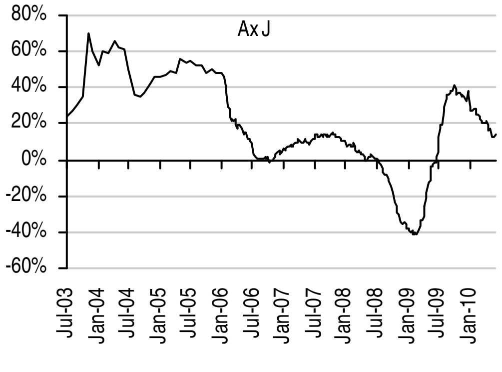
The truth is that Asia's growth bounced back first after the global recession of 2007-9 and that, by this time last year, the better news was largely priced in. Growth continues, but at no faster a pace that was clear 12 months ago. Asian stocks can continue to rise steadily, but only as further years' growth is priced in. Nominal GDP growth in Asia (which should be similar to earnings growth in the long run) is around 10%. The consensus forecast for 2011 EPS growth is 13%. That is probably as much upside for markets as investors should expect. Our index targets for Asian markets imply a rise in the overall regional index of about 8% by the end of this year.

Softening earnings

Perhaps the biggest concern in Asia and, in our view, the main reason for markets' underwhelming performance recently, is that earnings growth prospects have stagnated.

This first became clear at the end of last year with earnings momentum (which we measure as the change over the past six months in the 12-month forward consensus EPS forecast – see Chart 3). This bottomed in February 2009, earlier than the rest of the world, but peaked out at the end of October – whereas momentum in the US, for example, kept rising until May.

3. Earnings momentum – MSCI Asia ex Japan



Source: HSBC, IBES, Datastream

The peaking of momentum has been clear in all the Asia Pacific markets, with the exception of Australia (Table 4). The slowdown has, unsurprisingly, been sharper in cyclical markets such as Taiwan and Korea which had a strong rebound in earnings over the past 12 months, than in more structural growth markets such as India and Indonesia.

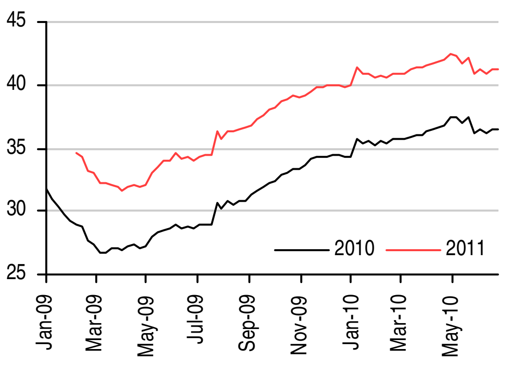
4. Earnings momentum by country

	Earnings momentum	3m ago	6m ago
Australia	22.5%	23.2%	17.8%
China	8.0%	11.0%	21.7%
HK	10.8%	14.7%	17.2%
India	12.6%	13.2%	14.7%
Indonesia	14.2%	16.3%	17.1%
Japan	28.1%	34.0%	55.1%
Korea	16.1%	19.9%	47.6%
Malaysia	11.5%	12.8%	17.0%
Philippines	10.0%	9.4%	10.0%
Singapore	11.7%	18.1%	21.1%
Taiwan	28.0%	42.9%	68.2%
Thailand	14.2%	10.9%	15.4%
Asia ex Japan	**13.6%**	**21.4%**	**35.2%**
Asia Pacific	**19.9%**	**25.9%**	**42.0%**

Source: HSBC, IBES, Datastream

But what worries us now is that in some countries the underlying earnings forecasts, not just the momentum, are also turning down. In Asia ex Japan, since the end of April the 2010 EPS forecast has been cut by 2.5% and the 2011 EPS forecast by 3.1% (Chart 5).

5. Consensus EPS forecasts – MSCI Asia ex Japan



Source: HSBC, IBES, Datastream

Initially, the downward revisions were only in China, but since mid-May, analysts have been paring back their numbers in most major markets, including India, Taiwan and Korea, as shown in Table 6.

6. Change in consensus EPS forecasts

		Jun	May + Jun	2Q	YTD
Asia ex Japan	2010	0.8%	-2.5%	1.3%	6.5%
	2011	0.8%	-3.1%	-0.4%	3.1%
China	2010	-0.9%	-0.4%	0.4%	-0.3%
	2011	-0.7%	-0.7%	0.0%	-0.1%
India	2010	-0.6%	0.1%	0.2%	0.9%
	2011	-0.5%	0.3%	1.3%	2.9%
Taiwan	2010	-0.6%	3.9%	8.5%	19.8%
	2011	-0.3%	0.5%	2.6%	8.1%
Korea	2010	-0.2%	2.5%	7.6%	12.3%
	2011	-0.4%	1.8%	4.2%	7.1%

Source: HSBC, IBES, Datastream

What are the causes of the analysts' concern – which, interestingly, have not been matched with cuts in earnings forecasts in any of the developed markets?

In the case of China, we think it was probably due to regulatory risks surrounding the inflationary pressures that emerged in the spring. The government began to keep down prices artificially in sectors such as energy and utilities, and analysts began to worry whether they would also do so in food and other sensitive areas. In some markets it may be connected with worries about European demand and particularly the weakness of the euro against some Asian currencies over the past couple of months. Note, from Table 7, how much some Asian currencies, particularly the yen but also the Malaysian ringgit and Indian rupee, have appreciated in trade-weighted terms y-t-d.

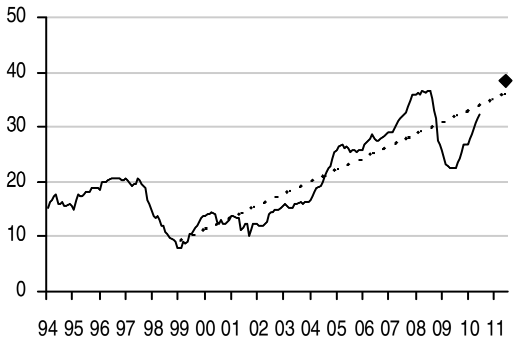
7. Change in trade-weighted currencies y-t-d

Currency	Change y-t-d
JPY	9.1%
MYR	7.1%
INR	3.8%
THB	3.5%
CNY	2.5%
SGD	1.0%
TWD	0.0%
KRW	-4.3%
AUD	-4.4%

Source: Bloomberg

But the most likely explanation is that analysts started to worry they had run ahead of themselves in forecasting. Even after the slight downgrades in recent weeks, analysts' forecasts still look quite punchy relative to history (Chart 8). The peak EPS for MSCI Asia ex Japan in the last cycle was USD36.7 in April 2008. We are already back to USD32.4, and analysts are forecasting USD36.3 for 2010 and USD40.9 for 2011. That would take EPS to a new record high by February next year and above the historic trend line in January.

8. Asia ex Japan EPS, with 12-month forward forecast



Source: HSBC, IBES, Datastream

Looking at this by market, only Australia, Japan, Hong Kong, Malaysia and Singapore will not be both at a new record-high for earnings and above trend by this time next year (Table 9). Forecasts for China, India and Korea look particularly high relative to history.

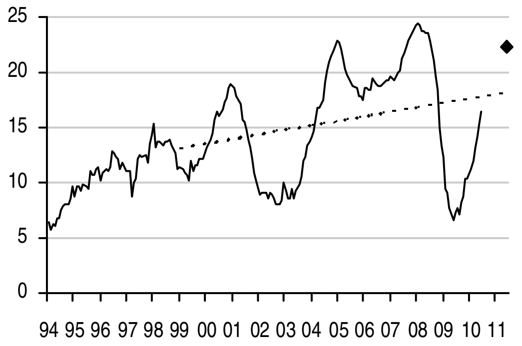
9. 12m forward consensus EPS forecast versus peak and trend

	Vs peak	Vs trend
AU	-1%	-1%
JP	-37%	-20%
CH	19%	22%
HK	-20%	-4%
ID	24%	8%
IN	21%	17%
KR	37%	28%
MY	-5%	-3%
SG	-12%	-5%
PH	10%	7%
TW	-9%	23%
TH	7%	-24%
AEJ	**5%**	**7%**

Source: HSBC, IBES, Datastream

Even in Taiwan, where we have argued previously that analysts' forecasts were still quite cautious, earnings are now expected to get back to close to previous highs over the next year (Chart 10). By June 2011, EPS will be well above trend, and only 9% below the peak from early 2008.

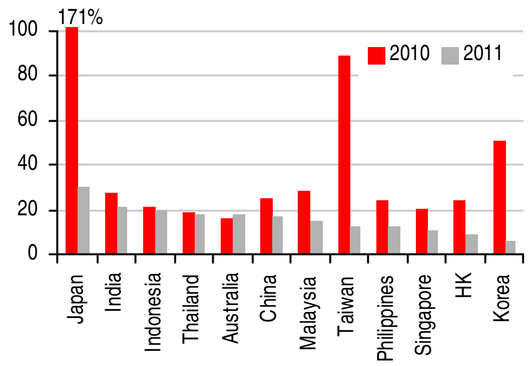
10. Taiwan EPS, with 12-month forward forecast



Source: HSBC, IBES, Datastream

All this suggests to us that, over the next few months, analysts in Asia will be increasingly cautious about their forecasts, looking for excuses to tweak their numbers down, rather than up. This could be particularly so for next year's forecasts, which analysts typically do not start to model seriously until September or October. Currently (Chart 11), analysts are looking for 13% growth for the region next year (after 37% growth this year). While that is not particularly aggressive, there are some markets (India 22%, Indonesia 20%, Thailand 18%) where analysts may want to become more cautious.

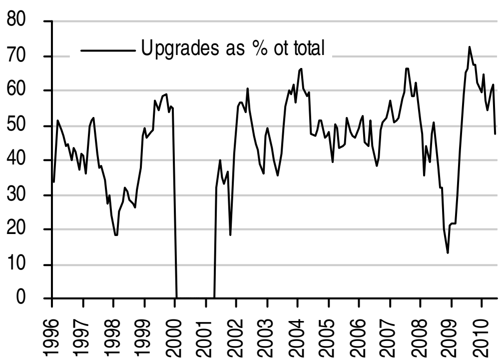
11. Consensus forecasts for 2010 and 2011 EPS growth



Source: HSBC, IBES, Datastream

This is likely to mean that the analysts' revision ratio (the percentage of upward revisions to total forecast changes), which has dipped below 50% over the past few weeks (Chart 12), will stay fairly subdued. In the past, this has had a good correlation with stock market movement. Until analysts have the confidence to start revising *up* their forecasts again, earnings expectations are likely to remain a drag on Asian equities.

12. Upgrades as % of total earnings revisions – Asia ex JP

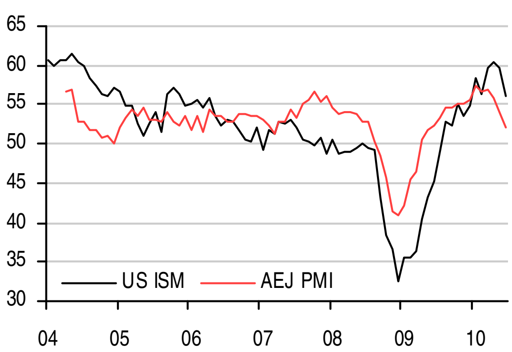


Source: HSBC, IBES, Datastream

PMIs turning down

A similar message is given by leading indicators such as PMIs. The US manufacturing ISM has fallen now for two consecutive months, to 56.2 from a peak of 60.4. In Asia, HSBC's PMI peaked as long ago as January and has fallen to 52.1 from 57.3 since then (Chart 13).

13. US manufacturing ISM and HSBC Asia PMI

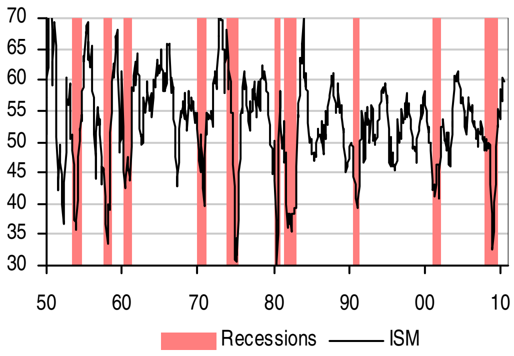


Source: HSBC, Bloomberg

But we would emphasise that there is nothing unusual about this at this stage of a recovery. It needs to be remembered that PMIs are essentially an indicator of month-on-month growth. A fall in the index from, say, 60 to 55 means, therefore, that the rate of growth is slowing, but not that output is falling. As long as the index stays over 50, growth continues to be positive.

Typically, therefore, PMI-type indexes rise very sharply after the end of a recession but then peak out after a year or so, as growth levels off. This can be seen clearly in Chart 14, which shows the US manufacturing ISM back to 1950, with the shaded areas denoting US recessions. Look, for instance, at 2004, 1994 or 1984 for recent examples of how, after reaching 60 or so, the ISM fell back to the 50 level or even below, without this heralding a new recession.

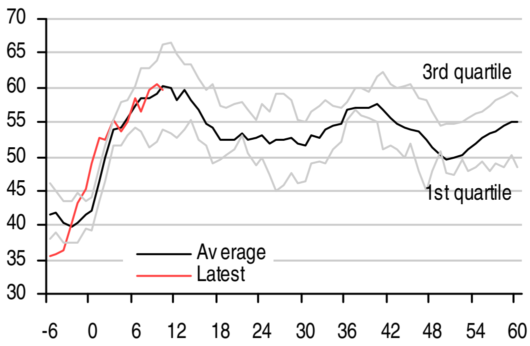
14. US manufacturing ISM and recessions



Source: HSBC, Bloomberg

In the current recovery, the ISM is moving almost exactly in line with the typical pattern (Chart 15). It peaked nine months after the likely bottom of the recession (which we assume was last July), compared to an historical average of 10 months. If it follows the usual pattern, it will fall to around 52 by the end of the year and has a 25% probability of falling to 50 or lower.

15. Average profile of ISM around recessions



Source: HSBC, Bloomberg (T0=month of recession bottom)

All this matters a lot for equity markets because PMIs, both global and local, have a very high correlation with the year-on-year change in Asian stock indexes.

Table 16 shows the correlation coefficient with the stock indexes of all the Asian markets for which HSBC produces a PMI. The data goes back to April 2004, except for India for which the PMI was first compiled in April 2005. Correlations between the local PMI and that country's index range from 0.62 in Singapore and India, to 0.88 in Hong Kong. The correlations with the regional PMI and with the US manufacturing index are equally good (and, in the case of the ISM, are similar even when we look at a longer history).

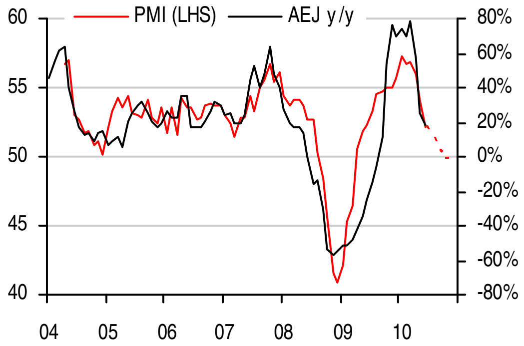
16. Correlation of PMIs with y-o-y index change

	Local PMI	Asia PMI	ISM
HK	0.88	0.85	0.78
China	0.72	0.78	0.55
Korea	0.67	0.78	0.79
Taiwan	0.65	0.79	0.71
India	0.62	0.83	0.84
Singapore	0.62	0.76	0.74
Asia ex Japan	**0.84**	**0.84**	**0.76**

Source: HSBC

The relationship between the overall regional PMI and the MSCI Asia ex Japan index is shown in Chart 17 (with the dotted part of the red line indicating what will be the y-o-y change in the index if it stays at its current level until the end of the year). The correlation is clearly quite good, although it is unclear whether the PMI has any lead over the stock index – it seems to have done so at the beginning of 2009's rebound, but not at the start of the recession in early 2008. In rough terms – and as one would expect – when the PMI is above 50, stocks rise and vice versa (we find the same with the ISM).

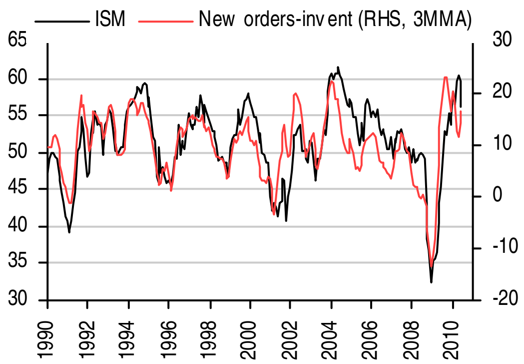
17. HSBC Asia PMI versus MSCI Asia ex Japan index y-o-y



Source: HSBC, Bloomberg

So how much further are PMIs likely to fall? The lesson from the history of the ISM, as discussed above, is that it could dip close to 50 over the coming months – although, for the moment, our favourite lead indicator of the ISM, new orders minus inventories, points to it falling to no lower than about 54-55 (Chart 18). In Asia, too, the PMI could easily flirt with 50 – in China, for example, it has already fallen to 50.4.

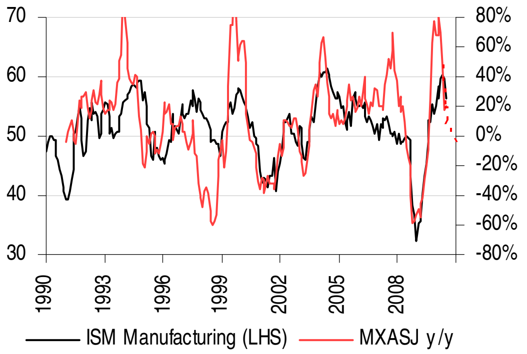
18. ISM new orders minus inventories



Source: HSBC, Bloomberg

But we would argue that the market has already priced in something like this. The projected y-o-y change in Chart 17 above, for example, suggests that at its current level the Asia ex Japan stock market is already discounting the PMI hitting 50 – but not falling any lower than that – over the next few months. It is a pretty similar story for the ISM (Chart 19).

19. US manuf. ISM versus MSCI Asia ex Japan index y-o-y



Source: HSBC, Bloomberg

An environment where these lead indicators continue to slip will obviously not be a particularly positive one for Asian equities – but the evidence suggests that a fall back to 50 is already priced in at the current level of the market. (We would add, though, that similar analysis for developed markets suggests they are anticipating something worse: a decline in the ISM to 45-47 by year-end.)

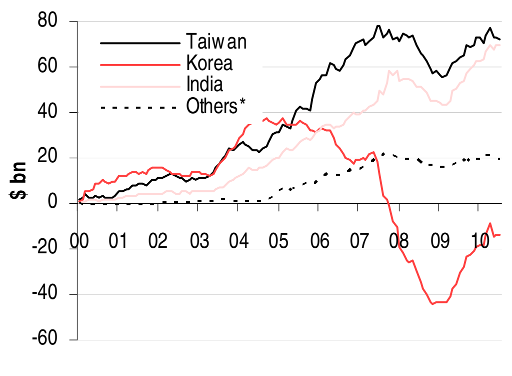
Vulnerable to risk aversion

We are moderately optimistic about the outlook for global equities over the rest of this year. In the Global Strategy Quarterly *Priced for imperfection*, 8 July 2010, we argue that the consensus is so bearish and valuations globally so cheap that, while the outlook for the global economy both for the remainder of this year and for the long term may be gloomy, the bad news is already priced in to stock markets.

But those investors who disagree with us and believe we are at the start of a new bear market should be wary of drawing the conclusion that Asia offers anything by way of a safe haven.

Asia remains particularly sensitive to the direction of global portfolio flows, and therefore to risk appetite. In May and June, for example, as investors turned risk-averse, they pulled USD17.8bn out of Japan, USD4.8bn out of Korea, USD4.4bn out of Taiwan and were net sellers even in Thailand and India. And this despite the fact that the risk aversion was caused by worries about (mainly European) sovereign debt that seem almost irrelevant to Asia. Don't forget, too, that in the Great Recession of 2007-9, Asia saw very significant foreign selling, USD91bn in 18 months, even excluding Japan (see Chart 20).

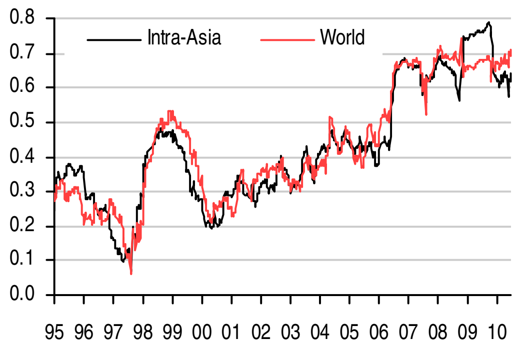
20. Foreign net buying of Asia equities



Source: HSBC, Bloomberg (*Sum of Indonesia, Thailand, Philippines, Vietnam)

This goes a long way to explain why the correlation of Asia with global equity markets has been so high in recent years (Chart 21). The average correlation between Asian markets and the World Index rose from around 20% in 2000 to 70% in 2006, and it has remained at that high level ever since.

21. Average correlation* between Asia markets and World

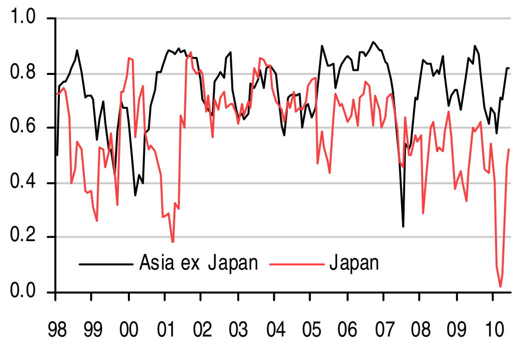


Source: HSBC, Datastream (*of weekly returns over past 12 months)

As an aside, though, we would note that, as Chart 21 also shows, the inter-correlation of Asian markets has fallen somewhat recently, from 80% at the beginning of 2009 to less than 60% this year. The matrix of correlations (Table 22) shows that Taiwan's correlation with other Asian markets has fallen particularly sharply: its correlation with MSCI China, for example, over the past year has been only 59% compared to 84% one year ago. Its correlation with Korea has also fallen to 60% from 78%. The correlations of Korea and Singapore with other Asian markets have also fallen. This may be because political factors – cross-Strait relations for Taiwan, a change of government in Korea – are playing an increasingly important role in deciding market direction.

The matrix also shows how closely correlated the MSCI China and Hong Kong indexes are with each other. It also indicates that, of Asia Pacific markets, Australia, Singapore and India have the highest correlations with global equities, and Japan, Thailand and the Philippines the lowest.

23. 12M rolling correlation: foreign buying and index change



Source: HSBC, Bloomberg

And the high correlations between Asia and global equities are quite clearly caused by Asia's dependence on foreign investors as the marginal buyer. Chart 23 above shows the 12-month correlation between the monthly return of the Asia ex Japan and Japan indexes and their foreign net buying during the month. The correlation with Japan has fallen somewhat over the past three or four years, but for Asia ex Japan it remains high at 80%. Each of the three markets that provide frequent foreign flow data (Korea, Taiwan and

22. Matrix of stock market correlations (using weekly returns over the past 12 months)

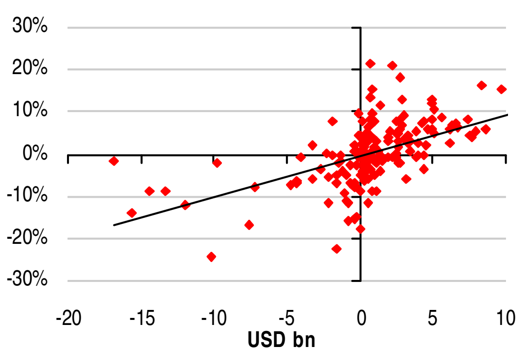
	AU	CH	HK	IN	ID	JP	KR	MY	PH	SG	TW	TH	US	WD
AU	-	73%	78%	84%	66%	48%	69%	75%	53%	79%	62%	48%	84%	90%
CH	73%	-	89%	79%	74%	37%	60%	80%	66%	79%	59%	53%	70%	75%
HK	78%	89%	-	78%	72%	45%	67%	78%	59%	85%	59%	52%	75%	81%
IN	84%	79%	78%	-	72%	45%	65%	76%	60%	83%	59%	62%	83%	86%
ID	66%	74%	72%	72%	-	34%	62%	71%	63%	69%	51%	58%	70%	70%
JP	48%	37%	45%	45%	34%	-	68%	47%	24%	38%	33%	45%	45%	51%
KR	69%	60%	67%	65%	62%	68%	-	75%	47%	64%	60%	45%	67%	69%
MY	75%	80%	78%	76%	71%	47%	75%	-	68%	74%	59%	54%	76%	79%
PH	53%	66%	59%	60%	63%	24%	47%	68%	-	61%	46%	45%	52%	53%
SG	79%	79%	85%	83%	69%	38%	64%	74%	61%	-	65%	44%	85%	87%
TW	62%	59%	59%	59%	51%	33%	60%	59%	46%	65%	-	38%	56%	56%
TH	48%	53%	52%	62%	58%	45%	45%	54%	45%	44%	38%	-	50%	51%
US	84%	70%	75%	83%	70%	45%	67%	76%	52%	85%	56%	50%	-	97%
WD	90%	75%	81%	86%	70%	51%	69%	79%	53%	87%	56%	51%	97%	-

Source: HSBC, Datastream

India) have a higher than 80% correlation with their foreign flows over the past year.

Indeed, if you look at the scatter graph of foreign net buying of Asian equities plotted against the monthly change in the index (Chart 24), there have been only eight months (out of 175) since 1995 when the index rose despite the fact that foreigners were selling.

24. Monthly MSCI Asia ex JP return vs net foreign buying



Source: HSBC, Bloomberg

Now, our expectation is that risk appetite will slowly come back over the next 12 months. That suggests foreign investors will be moderate net buyers of Asian equities. But investors who are much more gloomy than us should expect to see US and European money repatriated – which, judging by the past track record would be negative for Asian stocks.

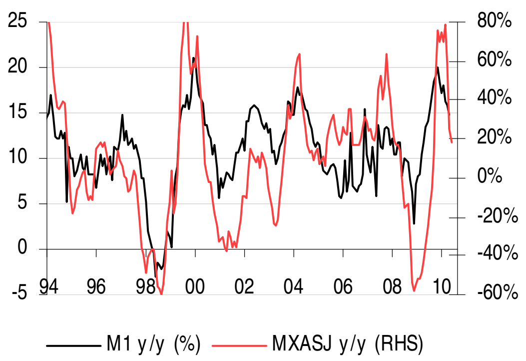
Some other worries

There are a number of other headwinds that will keep Asian equities in their rut.

Liquidity drying up…

To an extent, last year's rally was driven by liquidity, but a slowing of money supply growth recently makes it clear that this driver has petered out. M1 growth in Asia ex Japan, for example, has slowed from a peak of 20% in November to below 15% (Chart 25). China's M1 growth has slowed to 30% from a peak of 39%, Hong Kong's to 23% from 51%, Taiwan's to 15% from 29% and Korea's to 11% from 20%. Money supply growth is likely to come down further as monetary authorities slowly touch their foot on the brakes.

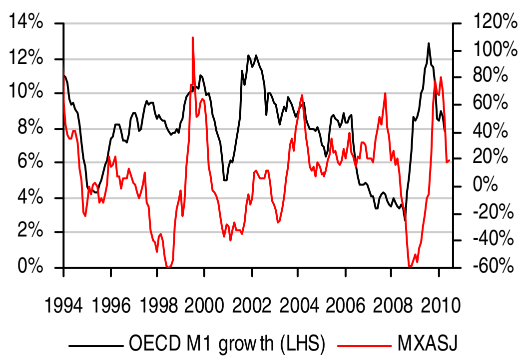
25. M1 growth versus MSCI Asia ex Japan index



Source: HSBC, Bloomberg

As far as global liquidity is concerned, it is a similar story. OECD liquidity has at times in the past (for example, 1999 or 2009) been a factor in the strong performance of Asian markets – it's those foreign flows again. But currently global M1 growth is slowing, as the effects of central bank rate cuts and quantitative easing from 2009 rub off (Chart 26). M1 growth is only 8% compared to a peak of 13% last August (and in the US 7% compared to 17%), and is likely to slow further unless central banks resume QE.

26. OECD M1 growth versus MSCI Asia ex Japan Index



Source: HSBC, Bloomberg

…but lots of issuance

We generally take the view that equity issuance is a product of strong markets and therefore not necessarily a negative factor. If the market falls, then the issues get cancelled. It is self-equilibrating. But the amount of issuance this year, especially in China and India, has been particularly large and is partly structural rather than driven by strong markets.

In Asia ex Japan, there have been USD78bn of new and secondary issues in the year to 21 June, which is 13% less at an annualised rate than the USD190bn in 2009 (Table 27).

27. Total equity issuance

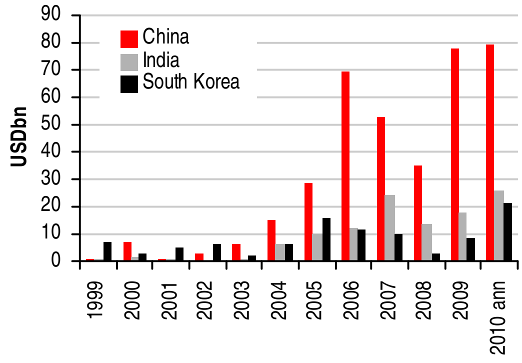
(USDbn)	2007	2008	2009	2010	2010* v 2009
AU	23.3	33.4	51.1	5.1	-79%
CH	53.1	34.9	77.7	37.2	2%
HK	20.7	4.5	13.5	5.0	-21%
IN	24.3	13.3	18.1	12.1	42%
JP	19.5	9.5	58.4	30.4	10%
KR	10.1	2.8	8.8	10.0	141%
MY	3.1	0.9	5.1	1.9	-21%
SG	6.1	1.5	8.5	1.8	-55%
TH	0.6	0.7	0.4	0.1	-30%
TW	8.9	1.3	3.2	0.6	-59%
AEJ	**158.0**	**101.4**	**190.1**	**78.0**	**-13%**
AP	**177.6**	**110.9**	**248.6**	**108.3**	**-8%**

Source: HSBC, Bloomberg (2010 is data to 21 June annualised)

But the overall number is held down by rather sparse issuance in ASEAN. On the other hand, China, India and Korea (Chart 28) are all issuing equity at a much faster pace than last year. And don't forget that this data does not include a large Chinese bank IPO scheduled to raise about USD20bn in early July.

And there is more to come. According to the estimates from HSBC's banking research team, the 12 Chinese banks will eventually need to raise a total of USD82bn to improve their capital adequacy. Excluding completed transactions, there is still USD64bn to be raised, with a USD17bn contribution from controlling shareholders such as Central Huijin and the Ministry of Finance and the rest from A-share (USD18bn) and H-share (USD29bn) investors.

28. Total new equity issues, China and India



Source: HSBC, Bloomberg (2010 is data to 21 June annualised)

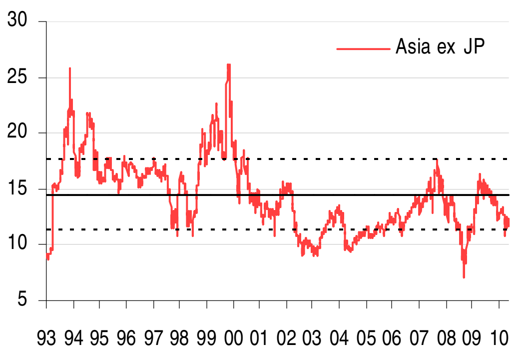
In India, too, new free float rules raising the minimum percentage of shares that must be publicly traded to 25% could, if implemented, require up to USD33bn of new issuance over the next three years.

It is hard to imagine how, in an environment where fundamentals are somewhat soft, this overhang of issuance does not represent an impediment to stocks booming.

Valuation cheap – but not that cheap

Since, over the past year, Asian equity markets have moved largely sideways but earnings have been revised up, valuations have become fairly cheap. The 12-month forward PE has fallen to 11.8x at the end of June. That compares with an average of 14.4x since consensus earnings data began in 1993 and 12.5x since 2001 (Chart 29).

29. 12-month forward PE, MSCI Asia ex Japan



Source: HSBC, IBES, Datastream

This is cheap, but not dramatically so. Out of the 12 markets in Asia-Pacific, four are currently on a PE higher than the post-2001 average, and another five are within 10% of it (Table 30). Some markets look really quite expensive compared to history, notably India and Indonesia, although bulls would argue that they perhaps deserve a re-rating. Asia ex Japan as a whole is 6% lower than its post-2001 average and 19% below its long-run average.

30. 12-month forward PEs by market

	PER now	Ave 2001-	% diff	Ave 1993-	% diff
China	12.0	12.9	-7%	13.2	-9%
HK	14.8	15.9	-7%	14.9	-1%
India	16.1	14.0	15%	13.7	17%
Indonesia	13.3	9.6	39%	12.8	4%
Korea	8.9	9.2	-4%	11.2	-20%
Malaysia	13.9	14.1	-1%	16.0	-13%
Philippines	14.1	13.9	2%	14.7	-4%
Singapore	13.5	14.7	-9%	16.2	-17%
Taiwan	11.7	14.5	-19%	18.2	-36%
Thailand	10.5	10.4	1%	20.1	-48%
Japan	14.2	19.4	-27%	30.6	-54%
Australia	11.3	14.4	-22%	14.9	-24%
Asia ex-Japan	**11.8**	**12.5**	**-6%**	**14.4**	**-19%**
Asia Pacific	**12.6**	**16.0**	**-21%**	**24.9**	**-49%**

Source: HSBC, IBES, Datastream

Compared with valuations in other regions – many of which are close to all-time lows – this is not so cheap. Russia, for example, is currently on a forward PE of 5x and Brazil on 9x. In Europe, the UK is on 9x and Spain on 8x (Table 31). In Asia, only Korea (8.9x) and Thailand (10.5x) would figure prominently in this table.

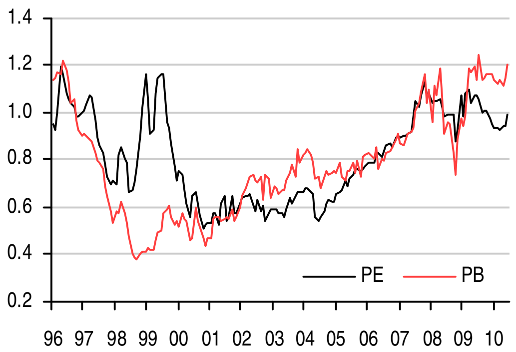
31. Consensus forward PEs for non-Asian MSCI indexes

Country	12m fwd PE
Russia	5.3
Spain	8.4
UK	9.0
Brazil	9.1
Italy	9.5
France	10.1
South Africa	10.3
Netherlands	10.5
Germany	10.8
Switzerland	11.2
US	11.6
Mexico	12.8
Canada	13.1

Source: HSBC, IBES, Datastream

The overall MSCI All Country World Index is on a PE very similar to that of Asia, 11.9x – but this is 1.4 standard deviations below its long-run average of 16.4x. It has been cheaper than this for only 5% of the time, with data going back to 1988.

32. MSCI Asia ex Japan PE and PB relative to MSCI ACWI

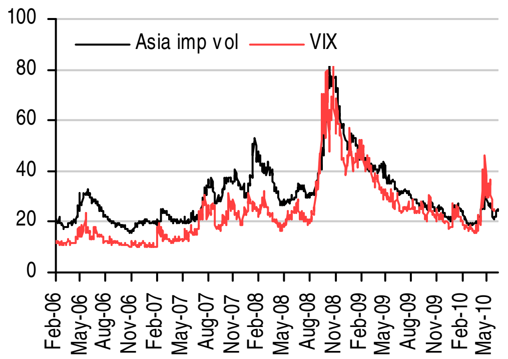


Source: HSBC, IBES, Datastream

So the key question is whether investors should be prepared to pay a similar valuation for Asia as for global equities, something they have not been willing to do in the past. As Chart 32 shows, historically Asia's PE has traded at an average 18% discount to the World (and sometimes as much as a 48% discount) and PB on average at a 21% discount, whereas currently PE is roughly the same and PB at a 20% premium.

One argument that says this is reasonable is that the volatility of Asian markets, which used to be at least double that of, for example, the US is now very similar. Chart 33 shows the US Vix Index (the implied volatility on S&P500 options) mapped against the implied volatility of six liquid Asian options contracts (KOSPI, Nikkei, Hang Seng, HSCEI, Taiex and Nifty). In the period before the credit crisis, the annualised volatility of the Asian markets was on average almost double that of the US: 21.5% versus 12.9%. During the crisis, they both rose to a similar level. And this year, they have again averaged almost the same: the Vix 22.7%, Asia 22.9%.

33. Volatility of Asian and US stocks



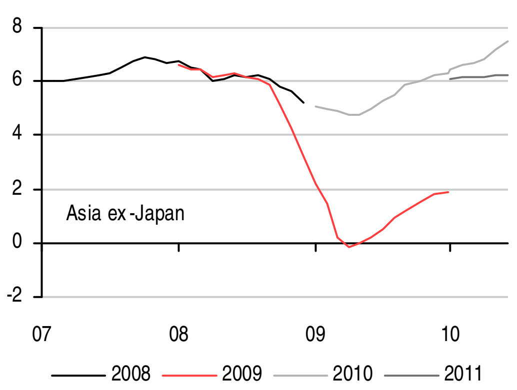
Source: HSBC, Bloomberg

Growth is still decent

So there are plenty of headwinds that make it unlikely that Asian equities will boom over the next few quarters. And valuations are not cheap enough that, on their own, they are sufficient a justification to buy Asian stocks (as we would argue they are in some other markets).

But before we start to sound too bearish, we see no reason to be pessimistic about Asia either. Growth is likely to continue in the region at a decent pace – and is under less threat from structural factors than it is in the West. Consensus GDP forecasts for this year continue to be revised up (Chart 34) and next year growth is not expected to be much lower than this year.

34. Consensus GDP forecasts Asia ex Japan (MSCI weighted)



Source: Consensus Economics

If the consensus among economists is right, then China will see 9.0% growth, India 8.5% and even Indonesia, Thailand, Korea, Malaysia and Taiwan 4-6% growth in 2011 (Table 35).

35. Consensus GDP forecasts by country

	2009	Change v 3m	2010	Change v 3m	2011	Change v 3m
China	8.5	0.2	10.2	0.3	9.0	-0.1
Hong Kong	-2.9	0.5	5.6	0.7	4.7	0.2
India*	6.6	0.5	8.3	0.1	8.5	0.6
Indonesia	4.5	0.2	5.9	0.2	6.0	-0.1
Korea	0.0	0.9	5.5	0.6	4.3	0.0
Malaysia	-2.2	0.8	6.9	1.5	5.2	0.2
Philippines	1.2	-0.1	5.1	1.1	4.5	0.0
Singapore	-2.1	2.0	9.1	2.9	5.0	-0.2
Taiwan	-3.4	0.7	6.5	1.5	4.5	0.0
Thailand	-3.0	0.7	5.1	0.4	5.1	0.6
Australia	1.1	0.3	3.0	-0.1	3.4	0.0
Japan	-5.3	0.4	3.2	1.3	1.7	0.1
MSCI weighted avg	-1.3	0.5	5.0	0.9	3.8	0.1
Asia ex-Jp avg	1.9	0.7	7.5	0.8	6.2	0.1

Source: Consensus Economics (*calendarised)

That sort of growth should produce decent returns from Asian equities in the long run. If analysts' earnings estimates come through as currently envisaged and the index is stuck at its current level it will be on a 12-month forward PE of 10.8x at the end of the year – and 9.7x by end-2011. That is starting to look super-cheap. The long-term attractiveness of Asian equities is intact, therefore – but investors will need patience.

Market recommendations

- We prefer markets with good long-term prospects that are still reasonably priced
- We downgrade Hong Kong to neutral and Japan to underweight while upgrading Australia to overweight
- Overweights: Korea, Indonesia and Australia; underweights: Japan, India, Malaysia, Thailand, the Philippines

Seeking growth at a reasonable price

Market sentiment is mixed. In some markets, such as China and India, investors are worried about overheating and how much more the government will have to tighten. In others, such as Indonesia, inflation has surprised on the mild side allowing the central bank to stay accommodative. Those markets in between are left confused: in Taiwan, for example, while the authorities are still worried about the robustness of the recovery, the central bank surprisingly hiked rates last month, mainly because of the strong property market.

Maintain overweight on Korea, Indonesia

In such a directionless market, we look for long-term growth stories that are still reasonably priced. For this reason, Korea and Indonesia are our favourites. We have been overweight Korea since Q2; we went overweight Indonesia after the market correction in mid-June. In our view, **Korea** offers the best risk/reward trade-off in Asia. Korean investors are paying the lowest price of 8.3x forward PE for an above-average EPS growth in 2010 of 49%. **Indonesia's** stable politics and exceptionally high return on equity make it attractive, too.

1. Market recommendations

Market	HSBC recommendation	Previously	Rel 3M Performance	End-2010 target	Current Index	Up/down side from current level
Japan	Under	Neutral	1.3%	900	837	7.5%
Australia	Over	Neutral	-10.5%	5,000	4,222	18.4%
China	Neutral	Neutral	1.7%	65	58	11.2%
Korea	Over	Over	-0.9%	2,000	1,675	19.4%
Taiwan	Neutral	Neutral	2.4%	8,000	7,440	7.5%
Hong Kong	Neutral	Over	3.1%	22,000	19,842	10.9%
India	Under	Under	3.5%	18,000	17,441	3.2%
Singapore	Neutral	Neutral	8.0%	3,000	2,844	5.5%
Malaysia	Under	Under	8.8%	1,300	1,300	0.0%
Indonesia	Over	Over	8.6%	3,200	2,877	11.2%
Thailand	Under	Under	6.4%	800	804	-0.5%
Philippines	Under	Under	10.4%	3,300	3,312	-0.4%

Source: HSBC, Note: Current Index and Rel 3M Performance as of 5th July 2010

Upgrade Australia to overweight

We raise **Australia** this quarter. The controversial resources tax caused the market to correct 10% after it was announced on May 2 and resulted in a change of Prime Minister. The new Prime Minister, Julia Gillard, immediately started discussions with the miners regarding a revised tax proposal that will meet the miners midway. The negative implications of the original 40% resources taxes are already priced in. Any final decision on a milder version of the tax proposal will surprise the market on the upside. Besides, Australia is a good way to gain exposure to Chinese growth via its resources sector. Valuations are still reasonable with a forward PE of 11.2x and conservative earnings expectations. The current consensus of 2010 earnings growth is only 16%. We see ample room for upside surprises in Australia.

Lower Hong Kong to neutral

Hong Kong underperformed MSCI Asia ex-Japan by 2% in Q2. There is nothing particularly wrong with Hong Kong's fundamentals, but it was dragged down by the underperformance of China (the correlation between MSCI China and MSCI Hong Kong is 89%). Hong Kong's valuation is not stretched, but its outlook will hinge on the performance of the Chinese market, on which we have had a neutral weighting for a while. It is logical, then, to be neutral on Hong Kong, too. We see the toppy property sector as a particular risk and, with the recent rise in Hibor, the liquidity story is no longer as compelling.

Lower Japan to underweight

We believe Japan's cyclical rebound has run out of steam. **Japan** has outperformed MSCI Asia Pacific by 2.5% year-to-date. But the outperformance ended in mid-May. Japan continues to face severe long-term structural issues such as an aging population and excess capacity that lead to sluggish growth and poor return on equity. The current forecast of the 12-month forward ROE is 6%, the lowest in Asia. The one potential upside we see for Japan is the tax reform and deficit reduction plan that the new Prime Minister Naoto Kan is hoping to implement. But it is premature to conclude whether he will push through with this, and whether the Bank of Japan will be prepared to back it with aggressive quantitative easing. Therefore, we are lowering Japan to underweight.

Maintain underweight on India, Malaysia, Thailand, Philippines

We remain unconvinced that the high valuation for **India** (forward PE of 17x) is justified. With inflation stubbornly high, we expect the central bank to tighten further which, given high valuations, seems not to be priced in.

Given that our strategy this quarter is to look for long-term growth stories at a reasonable price, Malaysia and the Philippines appear uninteresting. **Malaysia** trades at 13.4x forward PE, a 20% premium to the Asia ex-Japan average. Its long-term growth story will not be convincing until Prime Minister Najib Razak translates some of his market reform plans into actionable items. **The Philippines** is similar. It trades at forward PE of 13.3x but 2010 growth is forecast to be below the regional average (Philippines 23% vs Asia ex-Japan 36%). Although the recent election has stabilised local politics, we do not see any compelling growth drivers in the Philippines.

Thailand is a binary story. Valuations are cheap (PE is the second lowest in the region) and growth expectations are conservative: 2010 earnings growth is forecast to be at 19%. But, as for the past few years, the biggest worry in Thailand is the unstable politics and lack of clarity around the King's succession plan.

Results from the scorecard

We use a market scorecard (Table 2) to add some discipline to our market weighting process. The scorecard is not intended to be a quantitative model but rather a tool to help us systematically assess the factors that will drive market performance over the coming quarters.

Since our strategy this quarter is to seek long-term growth stories at a reasonable price, we increased the weighting of our "long-term story" factor in the scorecard to 15%. To balance that, we lowered our weighting of "beta" to 5% because it is less relevant in a market which we see largely moving sideways.

Below is a brief explanation of our market recommendations for this quarter. For more details on the major markets, please see the country pages in the "Main Markets" section later in this report.

Recommended weights

Overweights

Korea (stay overweight)

- Korea offers the best risk/reward trade-off in Asia. It is the cheapest market, with strong earnings growth. It also provides an inexpensive way to get exposure to Chinese growth.

Why overweight?

- The recent correction triggered by the dispute between North and South Korea presented a good buying opportunity
- Korea is the cheapest market in Asia with strong forecast 2010 EPS growth of 49%, and 5.5% real GDP growth
- Both the 12-month forward PE of 9.2x and PB of 1.3x are the cheapest in Asia. The historical discount to the region was due to the aftermath of the Asian Financial Crisis, which is no long justified

Risks to our call:

- MSCI's decision to delay the upgrade of Korea to developed market status prolongs an overhang that makes funds hesitate to invest in Korea until the next MSCI review in June 2011

Indonesia (stay overweight)

- A sustainable inflow of foreign funds and the highest return on equity in Asia have fueled the steady rise of the Indonesian stock market. Both the stability of the politics and macroeconomic policy continue to attract foreign investors.

2. Market Scorecard

	Monetary policy/ liquidity	Growth to surprise on upside/downside	Loved/ unloved	Newsflow/ shocks	Valuation	Beta	Long-term story	TOTAL	Rank	Weight
Weighting	*10%*	*20%*	*10%*	*20%*	*20%*	*5%*	*15%*	*100%*		
KR	0	0	1	1	2	2	2	1.10	1	O
ID	1	1	-1	1	-1	3	2	0.65	2	O
AU	-1	0	0	1	1	0	1	0.45	3	O
SG	0	1	-1	0	0	0	1	0.25	4	N
TW	0	-1	0	-1	1	1	2	0.15	5	N
HK	-1	0	-1	0	0	0	1	-0.05	6	N
CH	-1	-1	0	-2	0	2	3	-0.15	7	N
JP	0	0	0	0	0	0	-2	-0.30	8	U
MY	0	-1	1	-1	-1	-1	1	-0.40	9	U
TH	0	1	0	-3	0	1	-1	-0.50	10	U
IN	-2	0	-3	-1	-2	2	3	-0.55	11	U
PH	-1	0	0	-1	-1	1	-1	-0.60	12	U

Source: HSBC

Why overweight?

- Foreign fund inflow has been steady. Indonesia is the only Asian market that has seen net inflow every year in the past four years, including 2008 when all other Asian markets experienced a net outflow
- Inflation has surprised on the mild side so that the central bank can afford to prolong its accommodative stance
- The expensive valuation of 3.2x forward PB is supported by the consistently high return on equity. The current 12-month forward return on equity is estimated to be 24%, the highest in Asia. At 13x, forward PE looks more reasonable.

Risk to our call:

- The departure of former Finance Minister Sri Mulyani is not expected to slow the market reform. However, the market is watching closely whether the new Finance Minister Martowardojo will be able to stand up to opposition as well as his predecessor

Australia (upgrade to overweight from neutral)

- Newsflow from Australia should turn positive as the new prime minster is revising the resources tax proposal in the miners' favour. Earnings expectations are conservative despite steady growth and low valuations compared to history.

Why overweight?

- The recent correction was caused by the controversial proposal to impose a 40% tax on resources companies. This triggered the departure of Prime Minister Kevin Rudd. The new Prime Minister, Julia Gillard, is more open to negotiation with the miners
- Valuation of 11.2x forward PE places Australia at the low end of the Asian group, despite a decent return on equity of 13%. The highest dividend yield in Asia Pacific at 4.8% is another attraction
- Analysts' modest 2010 earnings growth forecast of 16% for Australia leaves ample room for upside surprise

Risks to our call:

- The real estate market shows signs of slowing, which might weigh on consumer confidence, especially if the central bank continues its hawkish monetary stance

Neutral

China (stay neutral)

- Investors still find the potentially inflationary structural labour shortage and the overheated property market worrisome. Regulatory risk remains high: the government will inevitably announce measures that cause market jitters. But the long-term growth story is intact.

Why neutral?

- Chinese companies will see margin compression with steadily rising labour costs. But the rising wages are positive for private consumption
- The resumption of currency reform will improve sentiment but the local government debt problem and measures to rein in rising property prices will confuse the market
- Valuation is fair with forward PE at 11.2x, in-line with the Asia ex-Japan average and at a discount to China's long-term average of 13.5x

Downside risk to our call:

- The lengthy consensus-building process between the incoming and outgoing leadership for the power transition in 2012 might divert efforts on market reform

Hong Kong (downgrade to neutral from overweight)

- We downgrade Hong Kong to neutral because of the toppy property market and shrinking liquidity. Hong Kong's performance will hinge on China, where we were already neutral

Why neutral?

- Hong Kong is a good way to get exposure to China with a milder impact from policy risk. However, it is a very open market so that external factors such as Chinese macro policy shift and a slowdown in global demand will weigh on sentiment
- An expensive valuation of 14x forward PE is not justified by the modest 2010 EPS growth forecast of 22%
- The interest rate environment should stay fairly accommodative because of the USD/HKD peg, although liquidity outflows have recently caused one-month Hibor to rise to 52bps from 8bps.

Downside risk to our call:

- Further economic tightening policies in China could be negative for sentiment on Hong Kong

Singapore (stay neutral)

- Singapore demonstrated its defensiveness in Q2. It outperformed Asia ex-Japan by 2%. Sentiment held up well because of the new casinos that boosted construction and tourism. But, as the casino effect is priced in, catalysts have also run out.

Why neutral?

- The 2010 earnings growth forecast of 20% is reasonable and valuations of 12.5x forward PE and 1.6x PB are also fair. But is hard to see much room for upside in either earnings or valuation
- The two new casinos have opened. Construction might now slow and unemployment might pick up, although steady tourism income should offset some of the negative effects
- Singapore's market contains many blue-chip companies with well-diversified operations and strong corporate governance. It is worthwhile to keep a market weight exposure to Singapore to add some defensiveness, with steady growth, to the portfolio

Downside risk to our call:

- Uncertainty on what the Monetary Authority of Singapore will decide at its October meeting

Taiwan (stay neutral)

- Taiwan's long-term story is compelling with the Economic Cooperation Framework Agreement (ECFA) now in place. But we see very few catalysts in the coming months and expect a lot of noise in Q3 around the supply/demand picture for the tech sector. Investors should balance their tech positions with some ECFA beneficiaries.

Why neutral?

- Now that ECFA has been signed and the first rate hike announced, there are no significant catalysts to swing the market either way in the quarters to come
- ECFA will enhance exporters' margins and open doors for Taiwanese companies to expand into the mainland. The long-term prospect is much rosier now, but it will take multiple years for results to come through
- While valuation is reasonable at 1.7x forward PB (roughly in line with the long-term average of 1.8x), 2010 earnings growth of 84% is the highest in Asia. We expect the consensus to reset

Upside risk to our call:

- Any landmark cross-Strait M&A deal would surely spark some excitement. However, the impact would not be sustainable unless it was also quickly given regulatory approval

Underweights

India (stay underweight)

- With forward PE at a 43% premium over MSCI Emerging Markets, India's valuation has fully priced in the robust earnings growth outlook. Investors continue to ignore domestic headwinds such as a skilled labour shortage and rising interest rates. The index will likely stay range-bound.

Why underweight?

- India's earnings are forecast by the consensus to grow at a 23% CAGR over the next three years. The robust growth is predominately funded by domestic consumption and investment, and is thus somewhat insulated from external shocks
- But investors continue to ignore domestic headwinds such as skilled labour shortages, constrained capacity, inflation and rising rates
- The current 17x forward PE represents a 43% premium to MSCI Emerging Markets. The historical premium was supported by the superiority of Indian return on equity, which is diminishing

Upside risk to our call:

- If inflation comes in lower than expected (HSBC's WPI forecast for end-2010 is 8.3% y-o-y, compared to 10.2% in May), then the central bank might have less pressure to tighten and investors' concerns that the central bank is behind the curve would be alleviated

Japan (downgrade to underweight from neutral)

- Japan's cyclical rebound is over. It is premature to conclude whether the new Prime Minister will be able to steer Japan out of its long-term structural problems.

Why underweight?

- Structural issues such as the aging population, inefficient tax system, persistently low return on equity and declining corporate competitiveness make Japanese equities unattractive
- The growth outlook has improved but the consensus real GDP growth forecast for 2010 has already risen to 3.2% from 1.3% over the past six months
- Foreign investors have turned into modest net sellers and valuations are not cheap with forward PE of 15x

Risk to our call:

- Japan would look more attractive if new Prime Minister, Naoto Kan, proceeds with an overhaul of the economy involving raising consumption tax, cutting corporate tax, reducing the fiscal deficit – all backed by Bank of Japan quantitative easing. But this is unlikely in our view because vested interests and political inertia will block the plan

Malaysia (stay underweight)

- The market has excessively high hopes for the 1Malaysia plan that was supposed to unify the nation, reform the market, and fight corruption. However, implementation is slow. Malaysia, as a defensive low-beta market, also tends to outperform the region only in a bear market

Why underweight?

- The recently announced new economic model lacks working details to make it a sustained positive for the market. Racial tension and corruption remain a hindrance to growth
- April's exports came in below expectations. We believe export growth will slow from now
- Valuation is unattractive. MSCI Malaysia trades on a forward PE of 13.4x, a 20% premium to MSCI Asia ex-Japan, though analysts expect only 23% EPS growth in 2010 (compared to Asia ex-Japan growth of 36%)

Risk to our call:

- Market sentiment would improve markedly if the government comes up with a workable market reform plan

The Philippines (stay underweight)

- The Philippines still lacks a compelling long-term story for investors. The recent drought and worsening fiscal deficit make the short-term outlook especially gloomy

Why underweight?

- Philippines trades at 13.3x forward PE. The valuation is fair given the mid-range 2010 EPS growth of 23%. But the sustainability of the growth is questionable without solid growth drivers in place
- Pre-election spending helped to support market sentiment, but its effect is fading now. The fiscal position is also expected to deteriorate due to an increase in personal tax exemptions and a rise in public service wages
- Remittances have held up well and support domestic demand. However, they are highly sensitive to global economic sentiment and might not be able to sustain growth

Risk to our call:

- New President, Benigno Aquino, is something of an unknown quantity, especially as regards economic policy. To complicate matters, former President Gloria Arroyo has been elected to Congress and may push again for constitutional change

Thailand (stay underweight)

- The economy is recovering well but political risk, in our view, makes exposure to Thailand unwise at the moment

Why underweight?

- The market expects a speedy recovery of tourism and exports now that the protest staged by the red shirts is over
- The market is not particularly cheap, despite the political risk. MSCI Thailand trades at 10.5x forward PE, slightly above its 10-year average. Thai 2010 earnings growth is expected to reach only 19.4%, half of the Asia ex-Japan average of 36%
- A by-election to fill a vacant parliamentary seat will take place on July 25. It will be the next check-point to see if Prime Minister Abhisit's administration has the Thaksin-inspired opposition under control

Risk to our call:

- If Q2 economic indicators do not show a sharp slowdown as the market expects and the July by-election takes place peacefully, foreign investors might return to the market sooner than expected

Sector recommendations/ investment themes

- Maintain overweight on cyclical sectors
- …but downgrade tech to neutral due to excess expectations
- Overweight: industrials, consumer discretionary and materials; underweight: consumer staples, healthcare and utilities

Downgrade tech to neutral

Increasing cyclical exposure was our key strategy last quarter. Despite noise arising from the European debt crisis and China's measures to cool its property sector, we think having a proper dose of cyclical risk is still the key to outperformance at this stage of the cycle.

Therefore, we largely maintain our sector stance with only one change: lowering the technology sector to neutral from overweight. The fundamentals of the tech sector are still strong, but expectations have run ahead. As a result of improved visibility, well-managed inventories and tight capacity, analysts have revised up their 2010 earnings growth forecast to 90%, almost triple that of Asia ex-Japan. Q2 shipments were misleadingly strong because some tech companies sent out their products by ship instead of air to lower costs. This means some Q3 orders were expedited to Q2. Therefore, a strong Q2 result does not necessarily presage a strong Q3. Furthermore, growing capital expenditure, although well paced, will start increasing supply in Q2. We think earnings expectations in the tech sector will need to be reset and may disappoint over the next couple of quarters.

Sector recommendations

Overweights

Industrials (stay overweight)

- Airlines are seeing cargo and passenger demand recover. Q3 is expected to be

Sector recommendations

Sector	HSBC recommendation	Previously	3m Performance	Market Overweight	Market Underweight
Financials	Neutral	Neutral	-1.6%	TW,IN	HK
Industrials	Over	Over	-0.1%	IN,TW,KR,CH	
IT	Neutral	Over	-2.4%	KR	
Consumer discretionary	Over	Over	-0.3%	TW	
Materials	Over	Over	-6.1%		IN
Telecoms	Neutral	Neutral	12.2%	HK	CH,TW,IN
Consumer staples	Under	Under	5.3%	TW	
Utilities	Under	Under	13.3%	HK	CH
Energy	Neutral	Neutral	-0.3%	CH	
Healthcare	Under	Under	6.0%		

Source: HSBC, Note: Current Index and Rel 3M Performance as of 5th July 2010 stronger as exporters start shipping out Christmas orders while capacity is still constrained. Our analysts prefer pro-cyclical airlines with strong earnings growth such as Cathay Pacific and Singapore Airlines

- Shipping companies should also see positive newsflow through Q3 before new capacity is added. Dry bulk will benefit from strong metal demand and the recent underperformance of ports-related stocks has thrown up many bargains. Our analysts like Sinotrans and Cosco Pacific

- Conglomerates underwent a correction in Q2 as many have significant exposures to Europe and Chinese property. But our long-term positive views on these well-run blue-chip companies are intact. HSBC analysts like Jardine Matheson, Astra, Swire and Wharf

- Industrials trades at 1.4x forward PB, the lowest sector in Asia ex-Japan. It expects an above-average 2010 earnings growth of 44%

Consumer discretionary (stay overweight)

- The consumer discretionary sector was the best performer in Q2, outperforming Asia ex-Japan by 7%. A negative wealth effect from softer property and stock markets in China has not materialised. But demand in China is likely to move inland and to smaller cities

- The 2x forward PB is expensive, but it is supported by the higher than average return on equity of 18%. The 11.2x forward PE is right in line with the market

- Our analysts like Hengdeli for its margin expansion and Esprit for valuation

Materials (stay overweight)

- The materials sector was the worst performer in Q2 amid concerns about global demand and the surprise resources tax proposed in Australia. Buying opportunities have therefore emerged.

- We like steel as the pick-up in demand for machinery and ship-building should be sufficient to keep the supply/demand balance tight. We also like coal as prices should be supported by the successful consolidation of small mines in China

- We expect margin squeeze for aluminium companies as China's National Development and Reform Commission (NDRC) ends the preferential electricity prices, which account for 40% of their production cost. We also worry about the fall in infrastructure construction and rising coal costs

- Posco is our top pick because of its attractive valuations. The recent rumour of the Korean government intervening in the steel price was unfounded. Our analysts also like China Coal and China Shenhua as they benefit most from volume growth and greater control over supply

Neutral

Energy (stay neutral)

- The supply loss from the BP spill in the Gulf of Mexico is greater than expected. Oil inventory is coming off a five-year peak

- The Chinese pricing mechanism is not transparent and the ability of refiners to pass through higher crude oil prices is questionable

- But petrochemical demand is strong. The new supply from the Middle East has been inconsistent and not enough to disturb the supply/demand balance

- The sector valuation is in line with the market. (MSCI Asia ex-Japan Energy trades at 11x forward PE vs MSCI Asia ex-Japan's overall 11.2x). Growth prospects in 2010 are also on par. The sector is forecast to have

32% 2010 EPS growth, roughly in line with the 36% forecast for MSCI Asia ex-Japan

- We prefer upstream to downstream. Our analysts' top pick is CNOOC due to its sizable oil discovery and attractive valuation

Financials (stay neutral)

- We like the financials sector in India as interest rate hikes over the next few quarters should lift margins. Money market liquidity has also tightened considerably
- China's 2010 loan growth is targeted at 18-20% but is likely to be exceeded. While bad debts are adequately provisioned for, the ongoing investigation of local government financing vehicles will cause the market to remain nervous about Chinese banks
- We like the banking sector in Taiwan despite its slow loan growth because the possibility of any cross-Strait merger will excite the market. However, Hong Kong and Singapore will continue see a sluggish outlook
- New accounting rules and risk capital requirements hang over the insurance sector. But the transparency of the Korea insurance sector should improve as more companies migrate to the embedded value methodology. Our analysts like Samsung Fire & Marine as it is well run and adequately capitalised
- The financials sector as a whole is cheap, trading at 1.4x forward PB, and the dividend yield of 4.4% is the second highest in Asia

Technology (downgrade to neutral from overweight)

- Weak European demand and slowing China demand have clouded the outlook for the tech sector
- Recent concerns will reset expectations but should not dent long-term growth prospects
- In addition to the overwhelming demand for the iPad and iPhone 4, there are other new products launching in 2H that should boost end-demand
- However, tech companies, although more disciplined than after the tech bubble, are increasing capital expenditure to raise supply later this year
- Some companies tried to save freight costs by sending out orders by ship instead of air, which means Q2 shipment was misleadingly strong and does not necessarily presage a strong Q3
- The tech sector already expects strong growth of 90% in 2010. We think the market has anticipated so much good news that it is at risk of surprising on the downside. We therefore downgrade tech to neutral from overweight

Telecoms (stay neutral)

- The popularity of smart-phones is driving up data usage. Telecoms companies with superior network quality will outperform. KT Corp in Korea is particularly attractive from this perspective and is our analysts' top telco service provider pick in Asia
- However, we are more cautious on India, China and Taiwan. In India, industry consolidation is necessary for Indian telcos to be profitable. In China, Unicom is shaking up the competitive landscape by taking market share from China Mobile. In Taiwan, telco growth is weak and China Mobile's proposed acquisition of a 12% stake in Far Eastone is unlikely to be approved by the regulator in our opinion
- One attraction of the sector is its high dividend yield. The 12-month forward dividend yield is forecast to be 5.8%, the highest in Asia

Underweights

Consumer staples (stay underweight)

- We are concerned about the consumer staples sector because Asian governments tend to intervene in the price of food and other consumer commodities in an inflationary environment
- Rising raw materials prices and labour costs also squeeze the margins of consumer staples companies as they have very little pricing power
- Valuation is expensive. The sector trades at 14.5x forward PE, 30% higher than the Asia ex-Japan average. 2010 earnings growth of 13% is also uninspiring
- China Mengniu, in our analyst's view, is a rare example of a consumer staples company that can offset margin pressure by upgrading its product mix.

Healthcare (stay underweight)

- Pricey valuation drives our underweight. The small healthcare sector is the most expensive in Asia ex-Japan. It trades at 17.4x forward PE. Its forward PB of 3.7x is also the highest in the region
- This sector tends to fluctuate on specific company news and highly exposed to regulatory risk.
- We recommend an underweight on healthcare to avoid idiosyncratic risk

Utilities (stay underweight)

- China's recent announcement to cancel the discounted tariff and raise the differential tariff for high energy usage industries has provided some room for power grids to pass through higher prices to independent power producers (IPPs)
- But IPPs continue to experience margin squeeze as coal prices increase. Uncertainties around power tariff reform still hang over the utilities sector
- The worry that local governments, after the central government delegated tariff reform to them, will not allow tariff hikes has been removed
- However, the natural gas wellhead price hike that came into effect on June 1 triggered concerns about the ability of city gas operators to pass through higher fuel costs to end-users
- Our analysts selectively like China Resources Gas for its strong bargaining power over tariffs due to its close relationship with local governments, and for potential asset injections from its parent
- Otherwise, we stay underweight on the utilities sector as a whole

Main markets

Japan (underweight)

- Japan had its usual cyclical bounce in January-April
- But momentum is slowing and foreigners cut their underweight
- We lower Japan to underweight from neutral

Cyclical boost over

We took our weighting up to neutral last October on the argument that Japan tends to outperform for about two quarters – usually at an early stage of a cyclical rebound – every five years. And, indeed, from the start of this year to mid-May, Japan outperformed MSCI World by 8% in USD terms. But we believe it is quite likely that the period of outperformance is now over, and so we are lowering our recommendation to underweight.

Growth forecasts have now been revised up quite sharply. The consensus forecast for 2010 real GDP growth has risen to 3.2% from 1.3% at the start of the year. The forecast for FY2010-11 EPS growth has also been revised up by 8% over that time. The prospects for growth now look much better than six months ago, but this is largely reflected in economists' and analysts' forecasts.

Foreign investors were hugely underweight Japan towards the end of last year, but they have rushed to buy this year to reduce the risk of such a big underweight. Foreigners bought USD48bn net of Japanese equities between December and April (compared to USD17bn in the whole of 2009), but have turned into modest net sellers since then. As a result, at the end of April global mutual funds' average weight in Japan was almost back to neutral: 8.8% versus a benchmark of 9.1%.

Japan tends to be a very cyclical market, with high dependence on overseas profits. Signs of a slowdown in cyclical momentum – for example, a peaking of the US ISM – which we expect to continue to emerge over coming months, typically cause this market to underperform.

And the long-term story remains poor. Japanese companies are forecast to make ROE of only 7% over the next 12 months, compared to 18% for emerging markets, 16% for the US and 13% for Europe ex UK. Demographics remain a drag: Japan's population has declined by almost 1 million since 2005 and is projected to shrink by another 5 million over the next decade. Japanese companies are losing competitiveness, demonstrated most dramatically by Apple's iPad where the battery is the only one of the 14 major components sourced from a Japanese company. Nor are valuations cheap, with forward PE of 15x.

One possible upside risk: the new Prime Minister, Naoto Kan, has some interesting proposals for tax reform (including cutting corporate tax) and deficit reduction. If these were backed by aggressive quantitative easing by the Bank of Japan (which it has been very resistant to until now), this could end deflation, weaken the yen and start to address some of Japan's macro and structural issues. It is more likely that vested interests and political inertia will block this, but developments need to be watched carefully.

1. Returns (%, USD)		
	MSCI Japan	TOPIX
3-month	-6.3	-4.9
6-month	0.4	1.2
12-month	4.6	-1.8
24-month	-23.3	-33.5

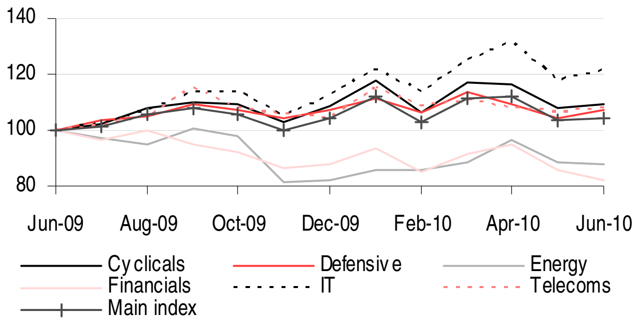
2. Valuation		
	2010	2011
PE (X)	16.2	13.3
P/B (X)	1.1	1.0
Dividend yield (%)	2.0	2.2

3. Q2 2010 Sectors Performance %			
Sector	Perf	Sector	Perf
Energy	-0.4	Consumer Staples	-4.9
Telecom	-2.5	Materials	-7.1
Technology	-2.8	Health Care	-8.8
Utilities	-2.8	Consumer Discretionary	-8.9
Industrials	-4.0	Financials	-10.2

4. Earnings (%)		
	2010	2011
Earnings growth (y-o-y)	170.6	30.5
ROE	6.8	7.8
ROA	1.2	1.6
Net debt/ equity ratio	10.2	43.0

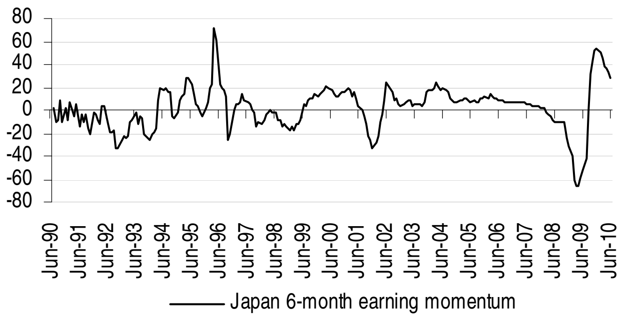
Notes: Performance for Q2 2010 is up to 21 June 2010; ^^ for full explanatory notes, Valuation & Earnings tables, please see Datapack section on page 49; Source: HSBC, I/B/E/S

5. Market performance



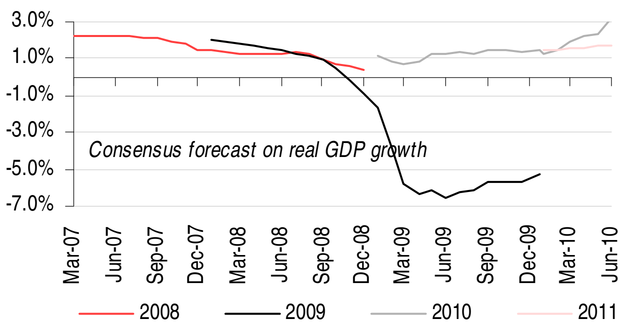
Source: HSBC

6. Earnings momentum



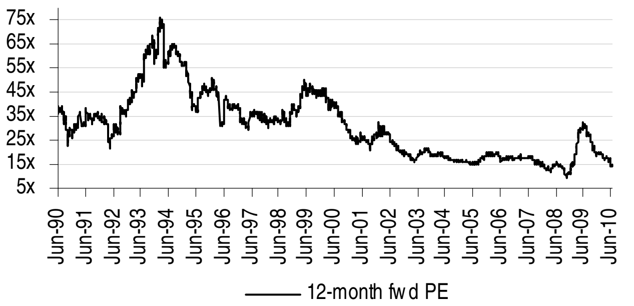
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



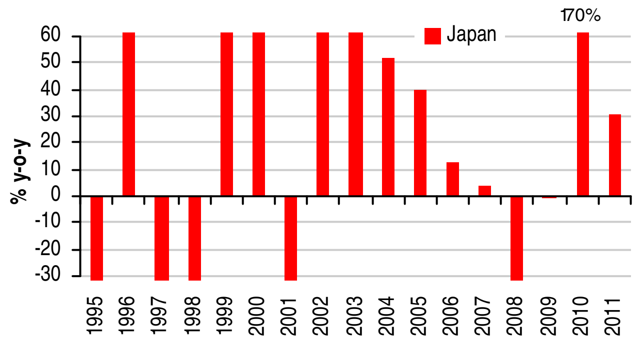
Source: Consensus Economics, HSBC

8. Valuation



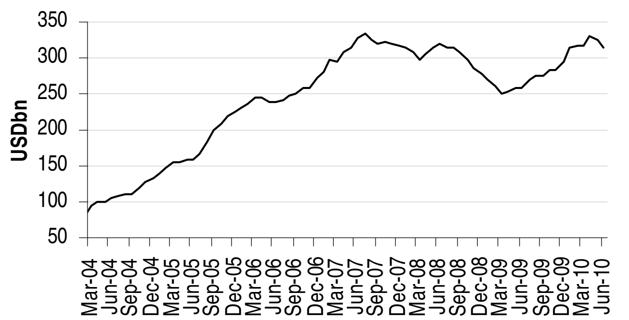
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: Bloomberg, HSBC

China (neutral) & Hong Kong (neutral)

- Stay cautious on structural concerns and economic transformation
- Cut targets further by 10-18%: MSCI China to 65; Hang Seng to 22,000; HSCEI to 13,000 and SHCOMP to 2,800 (5-15% upside)

Range-bound for now

We stay neutral on MSCI China; we downgrade MSCI Hong Kong to neutral as there is risk that liquidity may be leaving Hong Kong and because the local property market appears toppy. We also lower our index targets for the Chinese equity markets by 10-18%. The major considerations for our medium-term cautious outlook are:

- Profit growth and margin could initially be under pressure in China due to efforts to increase the share of labour compensation in the economy and boost consumption growth further. Between 1997 and 2007, for instance, corporate profits as a share of GDP rose by 11ppt, to exceed 31%, at the cost of labour compensation, which saw its share drop by 13ppt to just below 40%. This trend could be gradually reversed going forward.
- Structural concerns post the liquidity-driven recovery in 2009, such as a property market bubble in selected cities, the local government debt problem, and worries about banking sector asset quality will linger. Beijing has to break the well-entrenched expectation that property prices can only go up, in order to curb property market speculation. This means Beijing needs to keep up pressure on credit policy and eventually roll out tax-related measures, despite the technical challenges.
- As the power transition (October 2012) nears, the old and new generations of leadership could have different opinions about economic policies. Moreover, the prolonged process of consensus-building inevitably dilutes normal policy-making and execution, which could result in market confusion.

On the positive side, the recent resumption of currency reform helps to improve market sentiment towards the banking, property, insurance and consumer sectors. Moreover, the government has made accelerating urbanization a priority long-term goal in order to drive consumption and investment growth, since the urbanization rate is still below 50%. For instance, Beijing will speed up the building of 5.8mn units of economic housing in 2H, continue to liberalise the household registration system and reform the national income distribution system.

For sector allocation, we overweight energy (↑), consumer sectors, healthcare, IT and industrials (↑); are neutral on financials and materials (↓); and underweight on IPPs and telecoms.

China

1. Return (%, USD)

	MSCI China	HSCEI
3-month	-1.5	-1.0
6-month	1.8	-0.6
12-month	17.7	15.5
24-month	-1.2	-1.7

2. Valuation

	2010	2011
PE (X)	13.6	11.7
P/B (X)	2.2	1.9
Dividend yield (%)	2.6	3.1

3. Q2 2010 Sectors Performance %

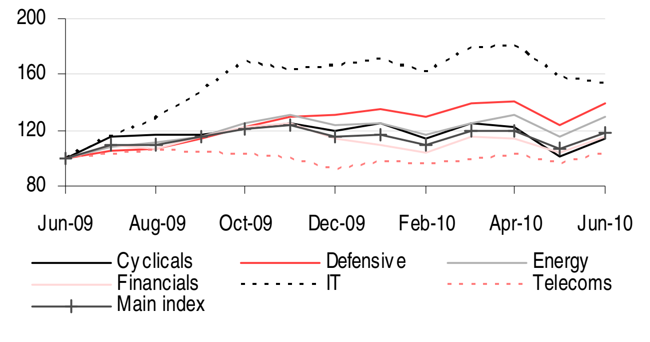
Sector	Perf	Sector	Perf
Telecom	4.4	Utilities	-5.6
Energy	3.0	Consumer Discretionary	-7.3
Consumer Staples	1.8	Industrials	-8.1
Health Care	1.2	Materials	-10.9
Financials	-0.2		

4. Earnings (%)

	2010	2011
Earnings growth (y-o-y)	24.9	16.6
ROE	15.8	16.4
ROA	2.4	2.5
Net debt/ equity ratio	-95.6	-99.7

Notes: Performance for Q2 2010 is up to 21 June 2010; ^^ for full explanatory notes, Valuation & Earnings tables, please see Datapack section on page 49; Source: HSBC, I/B/E/S

5. Market performance

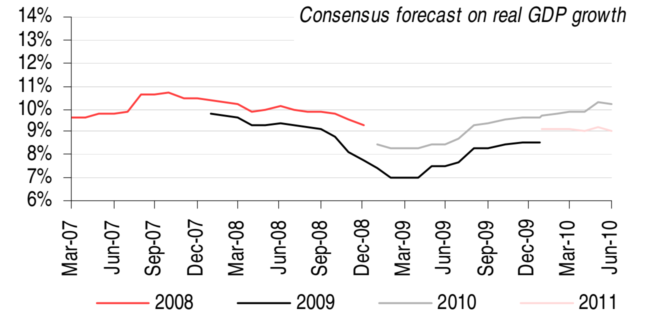


Source: HSBC

6. Earnings momentum

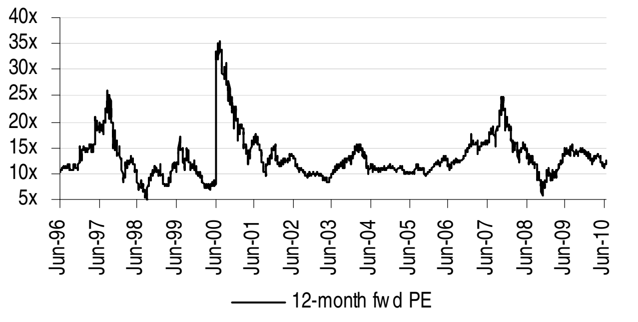
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



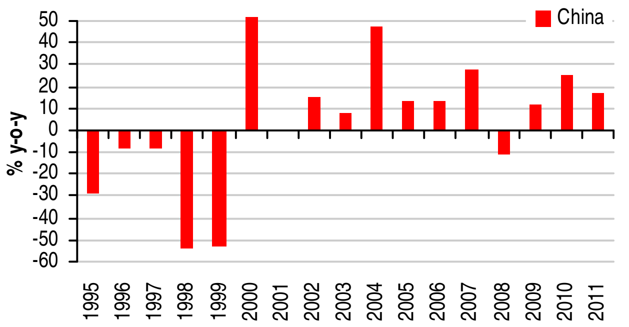
Source: Consensus Economics, HSBC

8. Valuation



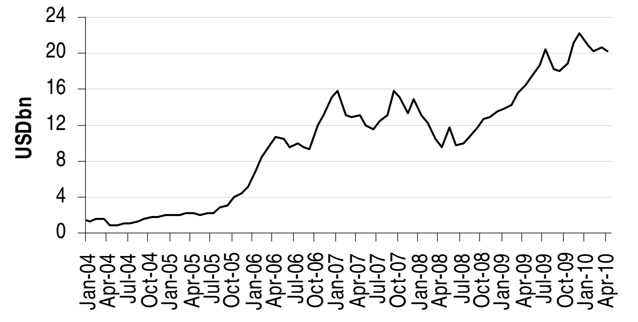
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

Hong Kong

1. Return (%, USD)

	MSCI Hong Kong	HSI
3-month	-5.2	-2.2
6-month	1.6	-0.2
12-month	16.9	16.7
24-month	-10.3	-8.1

2. Valuation

	2010	2011
PE (X)	15.9	14.6
P/B (X)	1.4	1.4
Dividend yield (%)	3.3	3.5

3. Q2 2010 Sectors Performance %

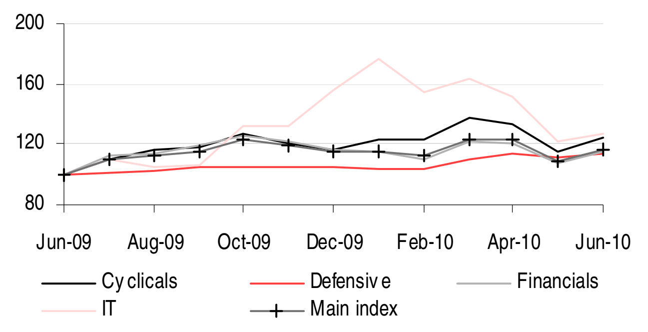
Sector	Perf	Sector	Perf
Utilities	3.2	Energy	-9.9
Telecom	-4.4	Industrials	-10.2
Financials	-4.9	Technology	-22.2
Consumer Discretionary	-9.4		

4. Earnings (%)

	2010	2011
Earnings growth (y-o-y)	23.7	8.9
ROE	9.0	9.3
ROA	3.5	3.7
Net debt/ equity ratio	9.9	5.6

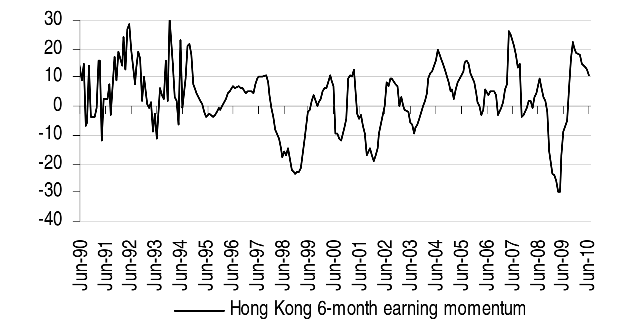
Notes: Performance for Q2 2010 is up to 21 June 2010; ^^ for full explanatory notes, Valuation & Earnings tables, please see Datapack section on page 49; Source: HSBC, I/B/E/S

5. Market performance



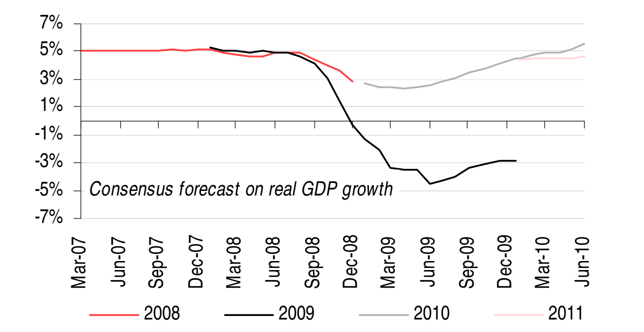
Source: HSBC

6. Earnings momentum



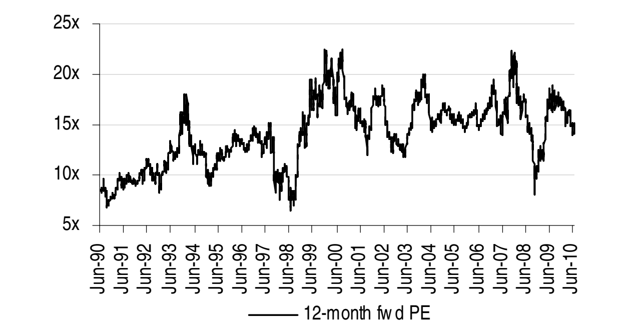
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



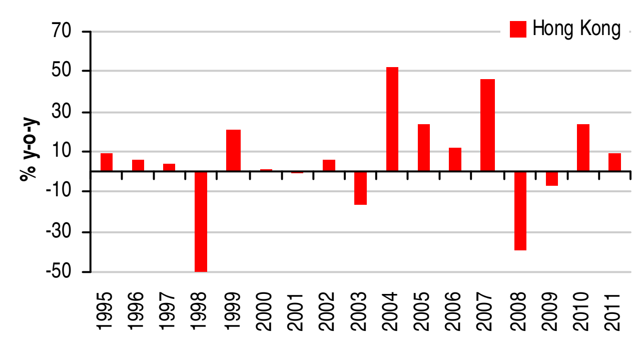
Source: Consensus Economics, HSBC

8. Valuation



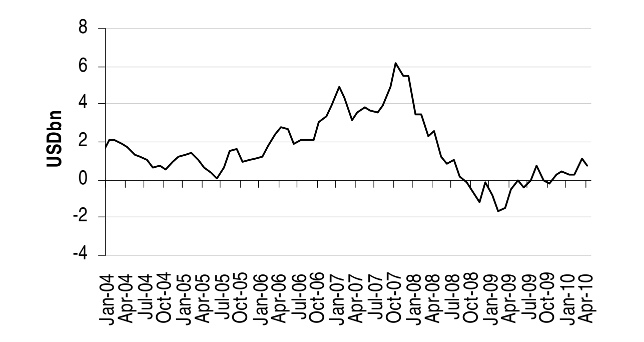
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

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HSBC

Korea (overweight)

- Korea is the cheapest market in Asia…
- …and has decent growth prospects, both short and long term
- This attractive risk/reward balance prompts us to stay overweight

Cheap valuation, good growth

Korea still seems to us to offer the best balance of risk and reward in Asia. It is the cheapest market in the region on a 12-month forward PE of 9.2x and a PB of 1.3x. While historically Korea has traded at a discount to the region, this was mainly in the aftermath of the Asian Financial Crisis, which in our view no longer represents a valid comparison.

Growth prospects remain good. The consensus forecasts 5.5% real GDP growth this year and 4.3% next. Korea's long-term trend growth rate remains about 4.5-5%, driven by its links to China. Perhaps this market's greatest attraction is as a low-risk, cheap-valuation way to get exposure to Chinese growth.

Earnings growth in 2010 is forecast to be strong at 49%, driven by one-off rebounds in telecoms and utilities. But next year's forecast of only 7% EPS growth looks quite cautious and stands a chance of being revised up. Earnings forecast momentum has been good, with the 2010 forecast revised up by 12% since the start of the year.

The market sold off in May after sabre-rattling by North Korea. But, historically, increased tension between the north and south has often represented a good buying opportunity for Korean stocks. Accordingly we reiterate the overweight stance we initiated last quarter, and keep our end-2010 target for the KOSPI to 2,000 (15% upside), which represents a forward PE of just over 10x.

There remain some risks. HSBC's economists expect the Bank of Korea to raise rates in Q3, which could lead to a period of underperformance. Domestic retail investors have shown a tendency to take profits on their mutual fund holdings once the KOSPI gets back to around 1,700, where there was a lot of buying in 2007-8 – although selling pressure has eased this year with funds seeing new inflows in two of the past four months. MSCI's decision in June not to raise Korea to developed market status leaves an overhang since MSCI will revisit the issue in 12 months. The upgrade, in our view, would be somewhat negative since GEMS funds would have to sell all their Korean stocks, and most global funds would not need to buy. And, of course, Korea is an export-oriented market and therefore sensitive to signs of a global slowdown.

In Korea, our favourite sectors remain technology and industrials (especially engineering companies). We are neutral on banks, although the risk of further write-offs for construction companies is falling and the promise of bank mergers could help pricing power. We are negative on shipbuilders, and also on autos whose share prices have recently risen sharply.

1. Returns (%, USD)

	MSCI Korea	KOSPI
3-month	0.4	3.2
6-month	6.9	5.8
12-month	42.2	25.8
24-month	-8.5	0.5

2. Valuation

	2010	2011
PE (X)	9.5	8.9
P/B (X)	1.4	1.2
Dividend yield (%)	1.4	1.6

3. Q2 2010 Sectors Performance %

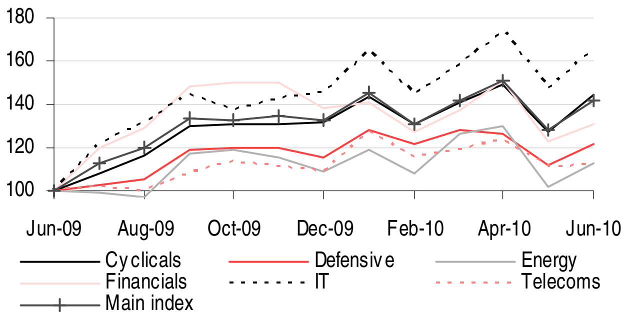
Sector	Perf	Sector	Perf
Consumer Discretionary	16.4	Financials	-4.9
Technology	4.4	Telecom	-6.1
Materials	0.9	Industrials	-8.0
Health Care	-0.4	Energy	-11.2
Consumer Staples	-1.0	Utilities	-15.5

4. Earnings (%)

	2010	2011
Earnings growth (y-o-y)	50.9	6.3
ROE	14.8	13.9
ROA	3.7	3.7
Net debt/ equity ratio	63.9	56.1

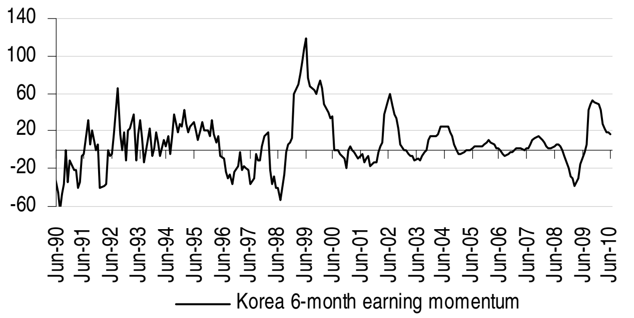
Notes: Performance for Q2 2010 is up to 21 June 2010; ^^ for full explanatory notes, Valuation & Earnings tables, please see Datapack section on page 49; Source: HSBC, I/B/E/S

5. Market performance



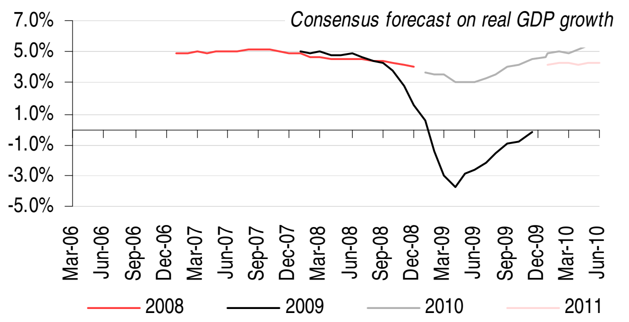
Source: HSBC

6. Earnings momentum



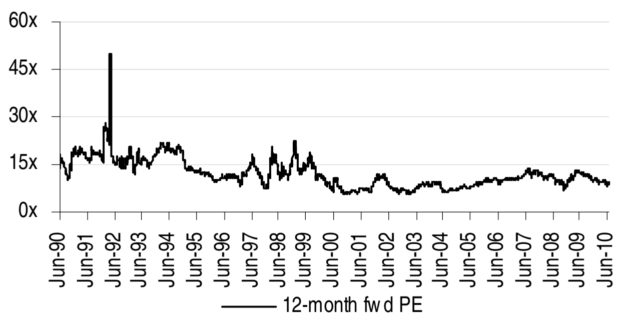
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



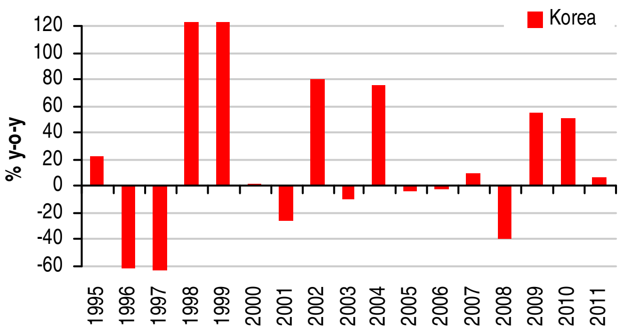
Source: Consensus Economics, HSBC

8. Valuation



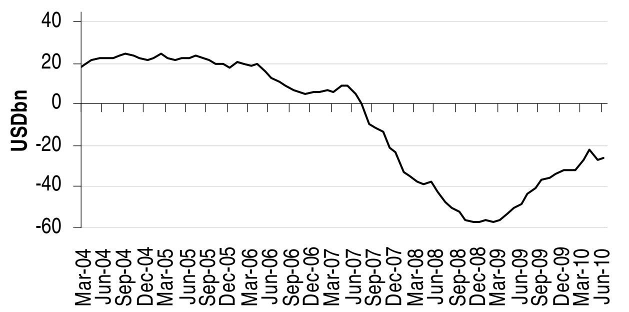
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: Bloomberg, HSBC

Taiwan (neutral)

- Taiwan is in for a multiple-year growth story after ECFA
- But there will be noise in the near term
- Keep modest exposure to Taiwan, especially ECFA beneficiaries

The post-ECFA era

The Taiwan government finally inked the Economic Cooperation Framework Agreement (ECFA) with Beijing. The central bank has so much confidence in ECFA's power to boost the economy that it surprised the market with the first rate hike to pre-empt any overheating of the economy. With ECFA in place, 800 products are subject to reduced tariffs that will be lowered to 0% over the next two years. Various service sectors, banking included, will be liberalised for cross-Strait expansion. We believe Taiwan's long-term growth story is compelling. Our economists raised the 2010 GDP growth target to 7.3% from 6.4%.

But it will take multiple years for Taiwan to achieve long-term success. In the near term, we see risks. Expectations have built up. The consensus 2010 earnings growth of 84% is the highest in Asia. Even if demand in Europe does not deteriorate, the weak euro and rising labour costs in China will squeeze the margin of many Taiwanese companies. In the technology space, some companies tried to reduce costs by sending their orders by sea instead of air. This means that many Q3 orders were expedited to Q2, misleading the market to believe that a strong Q3 is under way after the stronger-than-expected Q2 result. In our view, these negative impacts have yet to be digested by the market.

In an environment where few positive catalysts are in the pipeline, we think a neutral position for Taiwan is appropriate. The convincing long-term story and reasonable valuation prevent us from becoming more bearish. At the moment, MSCI Taiwan trades at 1.7x 12-month forward PB, still a touch below the long-term average of 1.8x. Its return on equity has returned to the pre-crisis level of 15%. High dividend yield is another attraction of Taiwanese equities. The current dividend yield of MSCI Taiwan is 4.7%, the highest in Asia ex-Japan. We expect 7% upside for TAIEX to end-2010 and set a year-end target of 8,000. This would bring the 12-month forward PB to its long-term average of 1.8x and implies a PE of 12.3x.

With this backdrop, we recommend investors to move away from a tech-centric portfolio in favour of a more balanced position focussed on ECFA beneficiaries that are also geared to reap the benefit of the Chinese consumption story. To this end, we like the materials sector which will benefit from reduced cross-Strait tariffs, airlines which will benefit from stepped-up cross-Strait tourism promotion, and the retail sector that will benefit from the consumption stories in both the mainland and Taiwan. We maintain our neutral stance on the technology sector anticipating a mid-cycle expectation reset, and an underweight rating for telecom due to its unexciting growth outlook.

HSBC

1. Returns (%, USD)

	MSCI Taiwan	TSE
3-month	-3.9	-3.3
6-month	-1.3	-2.0
12-month	24.2	22.5
24-month	-15.0	-3.4

2. Valuation

	2010	2011
PE (X)	13.1	11.6
P/B (X)	1.8	1.6
Dividend yield (%)	4.2	4.8

3. Q2 2010 Sectors Performance %

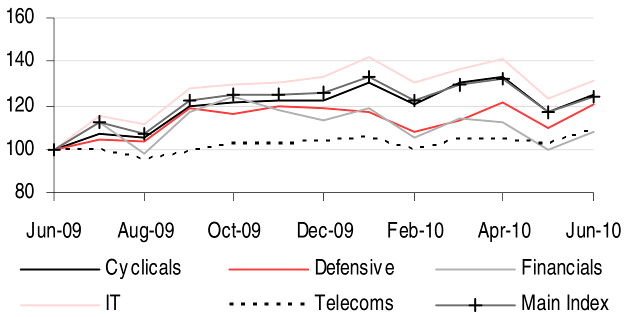
Sector	Perf	Sector	Perf
Consumer Staples	7.1	Energy	-1.9
Telecom	4.9	Technology	-4.2
Industrials	4.4	Financials	-6.0
Consumer Discretionary	0.9	Materials	-7.1

4. Earnings (%)

	2010	2011
Earnings growth (y-o-y)	89.7	12.9
ROE	13.6	14.2
ROA	3.5	3.4
Net debt/ equity ratio	-0.3	-2.2

Notes: Performance for Q2 2010 is up to 21 June 2010; ^^ for full explanatory notes, Valuation & Earnings tables, please see Datapack section on page 49; Source: HSBC, I/B/E/S

5 Market performance

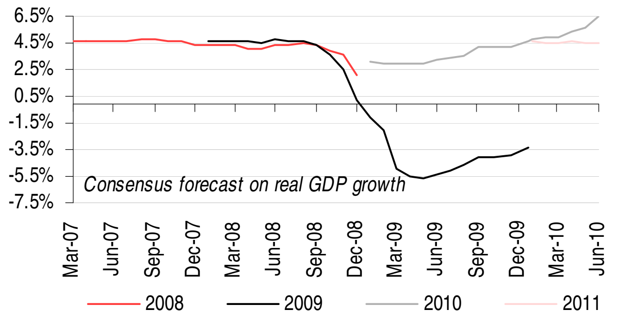


Source: HSBC

6. Earnings momentum

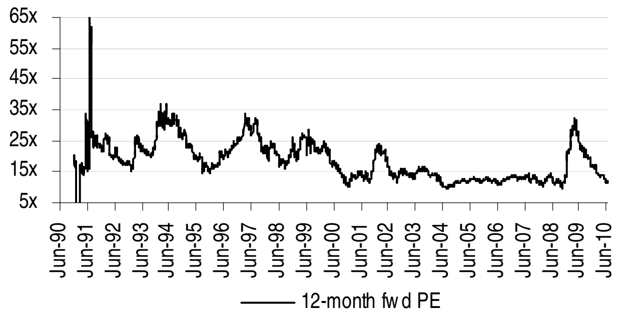
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



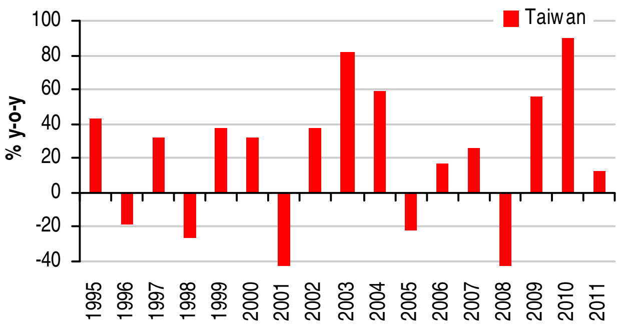
Source: Consensus Economics, HSBC

8. Valuation



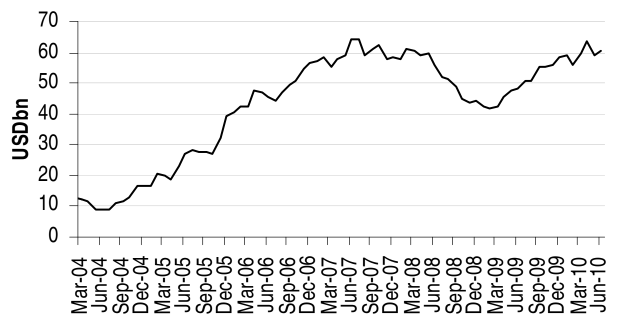
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: Bloomberg, HSBC

India (underweight)

- Growth outlook remains robust – 23% EPS CAGR for next 3 years
- But high valuations and rising rates are likely to cap the upside
- We stay underweight, with a Sensex target of 18,000 for year end

Insulated, but expensive

We remain underweight on India.

India's mid-to-long-term earnings outlook remains robust (23% EPS CAGR over the next three years) and has good visibility since it is fuelled largely by domestic consumption and investment. However, India's valuation is rich relative to other markets (17x forward PE – a 43% premium to MSCI Emerging Markets) and in the near term could be tested by rising interest rates (our economists expect another 25bps rise in the scheduled monetary policy review on July 27 after the 25bps surprise hike). In the short term, we expect the market to be range-bound.

Furthermore, India's premium valuation has historically been on account of higher ROEs (550bps above the EM average). However, the superiority of Indian ROE is forecast to fall to about 100bps over the next two years. This means a premium valuation for India is hard to justify.

Although strong growth, positive surprises in economic data and also potentially in corporate earnings may serve as positive catalysts, there is also near-term risk of a capacity crunch (capacity utilisation is at 96%, near its previous cycle high, and 45% of employers report shortages of skilled labour, increasing the risk of a wage/price spiral). This implies that inflationary pressures will persist and may weigh on valuations. Given already expensive valuations, we believe it is unlikely that upside surprises to earnings will result in significant upside to the market.

Separately, although India's exposure to global structural risks (sovereign debt, fiscal consolidation, external borrowing) is minimal and its dependence on exports is modest (17% of GDP) the market is still highly sensitive to foreign investor portfolio flows, and an increase in global risk aversion could hurt India disproportionately given its premium valuation. This remains a key short-term swing factor in our view.

New free float rules, if implemented, will cap promoters' holdings at 75% and could require up to USD33bn of new issuance over the next three years, and this supply of paper may also serve as a drag on valuations.

At a sector level, we favour sectors most likely to benefit from the pick-up in growth: banks, industrials and infrastructure. We are underweight telecoms because of competitive intensity, and materials (except steel) as this sector is most at risk of downside surprises to EPS. We are neutral on consumer discretionary, consumer staples, utilities, oil & gas, and healthcare.

We have lowered our preference for IT services from overweight to neutral given its below-average growth (14% two-year EPS CAGR vs. 23% for MSCI India), its 25% PE premium valuation (21x vs. 17x), and its relatively higher exposure to the global economy.

1. Returns (%, USD)

	MSCI India	SENSEX
3-month	0.3	1.7
6-month	9.8	7.7
12-month	33.2	23.1
24-month	14.9	22.7

2. Valuation

	2010	2011
PE (X)	17.2	14.1
P/B (X)	2.8	2.4
Dividend yield (%)	1.2	1.3

3. Q2 2010 Sectors Performance %

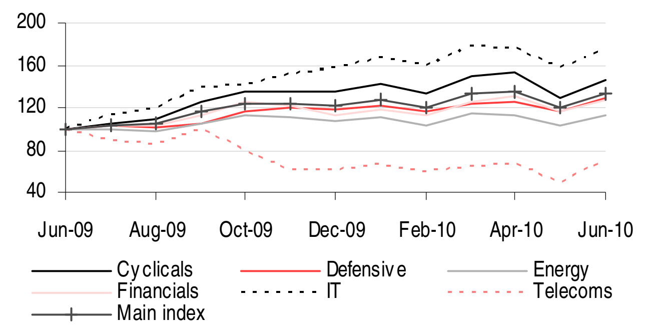
Sector	Perf	Sector	Perf
Consumer Staples	9.2	Health Care	2.5
Consumer Discretionary	9.1	Industrials	1.0
Telecom	7.8	Energy	-0.1
Utilities	3.9	Technology	-1.4
Financials	2.9	Materials	-11.1

4. Earnings (%)

	2010	2011
Earnings growth (y-o-y)	27.4	21.7
ROE	16.3	17.1
ROA	3.6	3.9
Net debt/ equity ratio	39.2	18.4

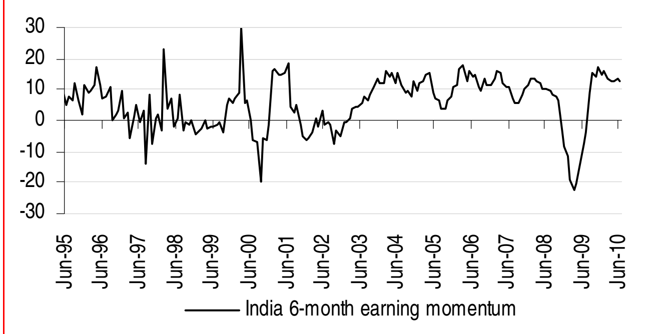
Notes: Performance for Q2 2010 is up to 21 June 2010; ^^ for full explanatory notes, Valuation & Earnings tables, please see Datapack section on page 49; Source: HSBC, I/B/E/S

5. Market performance



Source: HSBC

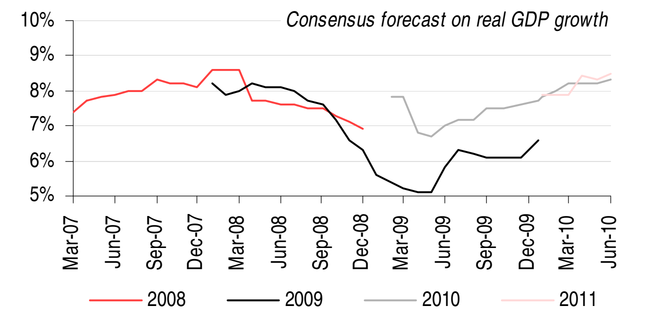
6. Earnings momentum



Note: Earnings momentum = 6M % change in 12M forward consensus forecast

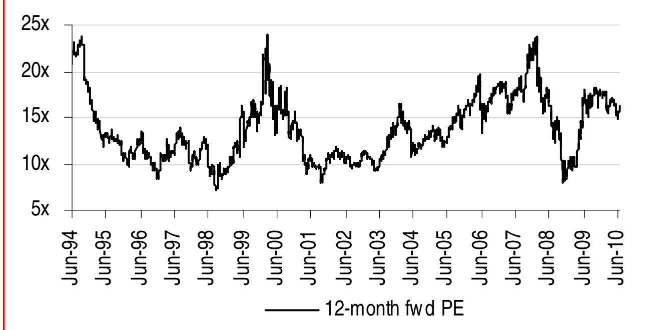
Source: HSBC

7. Economy



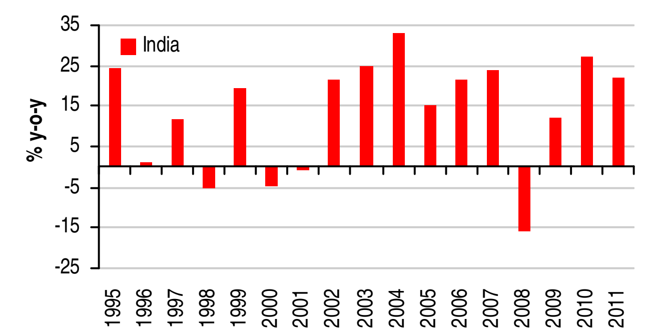
Source: Consensus Economics, HSBC

8. Valuation



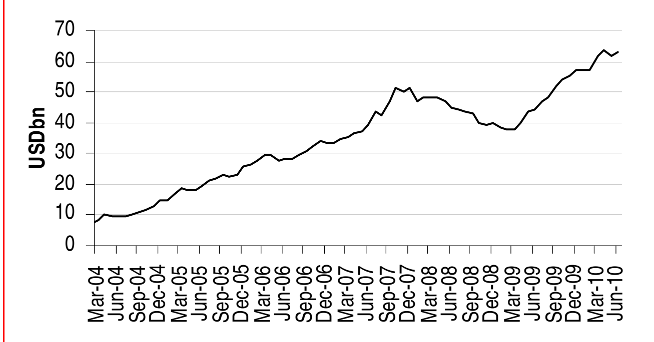
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: Bloomberg, HSBC

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Other markets

Australia

1. Return (%, USD)

	MSCI Australia	S&P/ ASX 200
3-month	-9.6	-5.3
6-month	-0.8	-0.5
12-month	29.2	18.3
24-month	-17.7	-12.8

2. Valuation

	2010	2011
PE (X)	14.9	12.1
P/B (X)	1.9	1.8
Dividend yield (%)	4.2	4.6

3. Q2 2010 Sectors Performance %

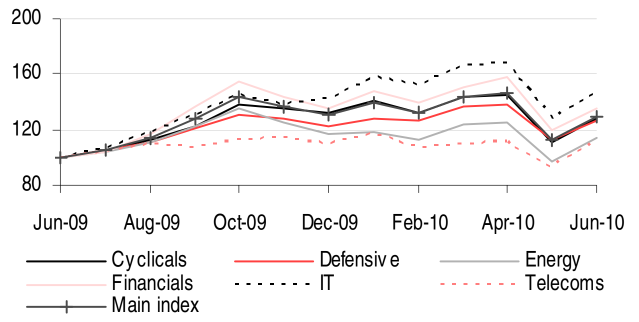
Sector	Perf	Sector	Perf
Telecom	1.3	Materials	-9.5
Utilities	-6.2	Financials	-10.1
Consumer Staples	-6.5	Consumer Discretionary	-10.7
Energy	-8.2	Technology	-11.9
Health Care	-9.4	Industrials	-17.0

4. Earnings (%)

	2010	2011
Earnings growth (y-o-y)	16.0	17.4
ROE	13.0	14.9
ROA	3.0	3.3
Net debt/ equity ratio	139.9	130.3

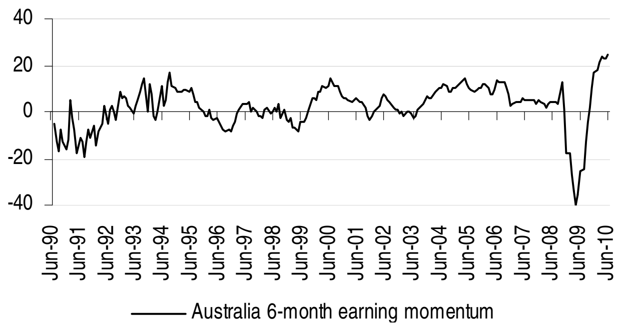
Notes: Performance for Q2 2010 is up to 21 June 2010; ^^ for full explanatory notes, Valuation & Earnings tables, please see Datapack section on page 49; Source: HSBC, I/B/E/S

5. Market performance



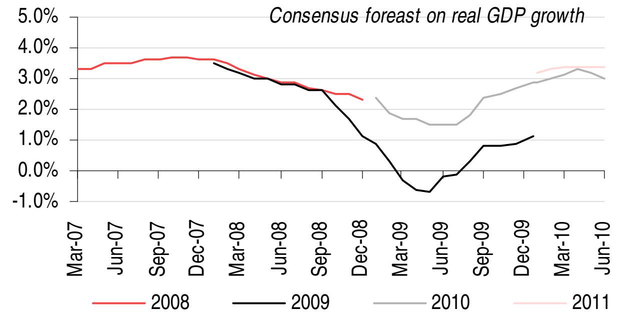
Source: HSBC

6. Earnings momentum



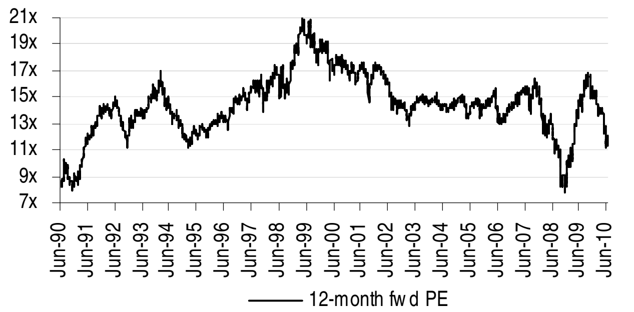
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



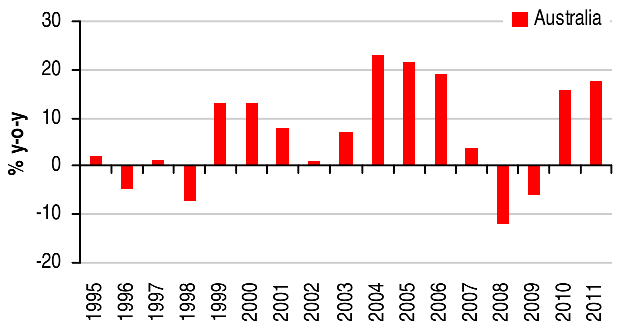
Source: Consensus Economics, HSBC

8. Valuation



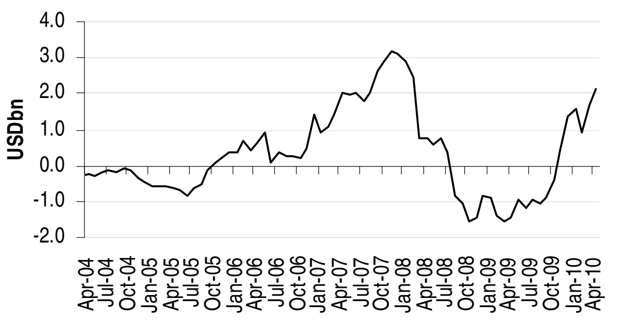
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

Singapore

1. Return (%, USD)

	MSCI Singapore	STI
3-month	0.7	-1.0
6-month	4.7	3.6
12-month	32.0	26.9
24-month	-7.6	-3.9

2. Valuation

	2010	2011
PE (X)	14.3	13.0
P/B (X)	1.7	1.6
Dividend yield (%)	3.4	3.7

3. Q2 2010 Sectors Performance %

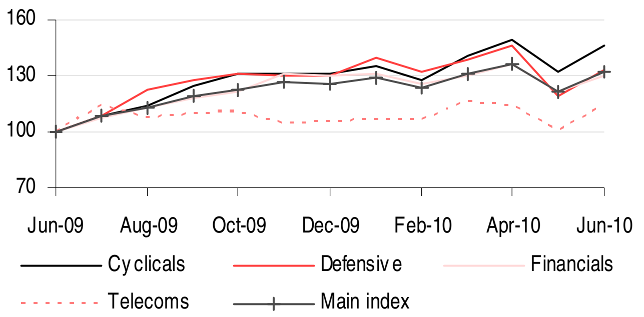
Sector	Perf	Sector	Perf
Consumer Discretionary	13.3	Telecom	-1.8
Industrials	1.1	Consumer Staples	-3.6
Financials	0.1		

4. Earnings (%)

	2010	2011
Earnings growth (y-o-y)	20.6	10.5
ROE	11.7	12.1
ROA	2.8	2.7
Net debt/ equity ratio	-1.1	-0.1

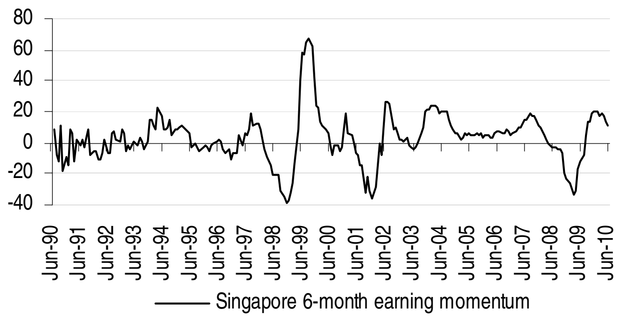
Notes: Performance for Q2 2010 is up to 21 June 2010; ^^ for full explanatory notes, Valuation & Earnings tables, please see Datapack section on page 49; Source: HSBC, I/B/E/S

5. Market performance



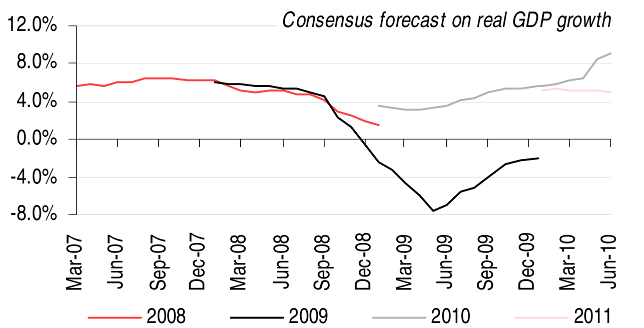
Source: HSBC

6. Earnings momentum



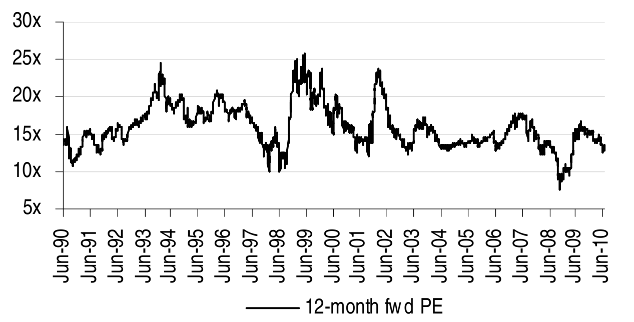
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



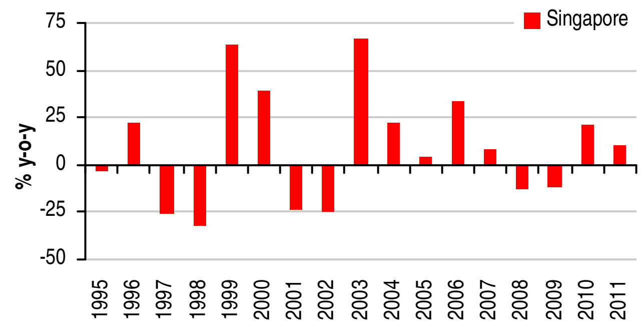
Source: Consensus Economics, HSBC

8. Valuation



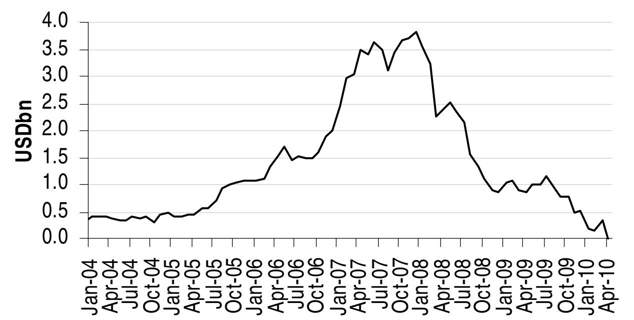
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

Malaysia

1. Return (%, USD)

	MSCI Malaysia	KLSE
3-month	6.5	3.2
6-month	13.2	5.8
12-month	37.1	25.8
24-month	12.3	0.5

2. Valuation

	2010	2011
PE (X)	15.6	13.6
P/B (X)	2.0	1.9
Dividend yield (%)	3.1	3.5

3. Q2 2010 Sectors Performance %

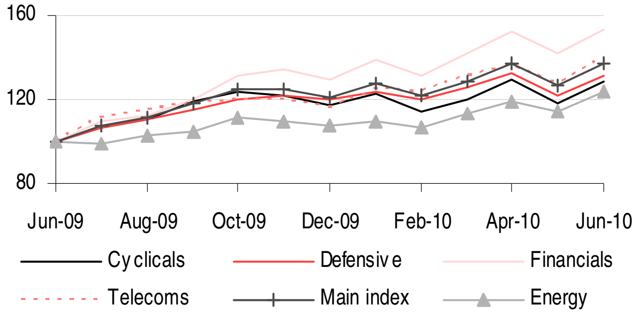
Sector	Perf	Sector	Perf
Materials	11.2	Financials	8.0
Energy	9.6	Telecom	6.3
Consumer Discretionary	9.5	Industrials	5.2
Utilities	8.2	Consumer Staples	1.4

4. Earnings (%)

	2010	2011
Earnings growth (y-o-y)	28.5	15.1
ROE	12.8	13.7
ROA	2.6	2.9
Net debt/ equity ratio	13.6	6.0

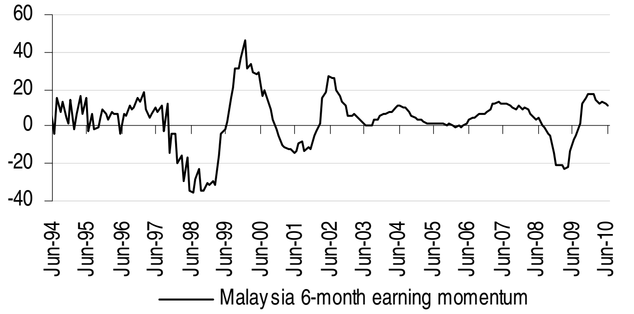
Notes: Performance for Q2 2010 is up to 21 June 2010; ^^ for full explanatory notes, Valuation & Earnings tables, please see Datapack section on page 49; Source: HSBC, I/B/E/S

5. Market performance



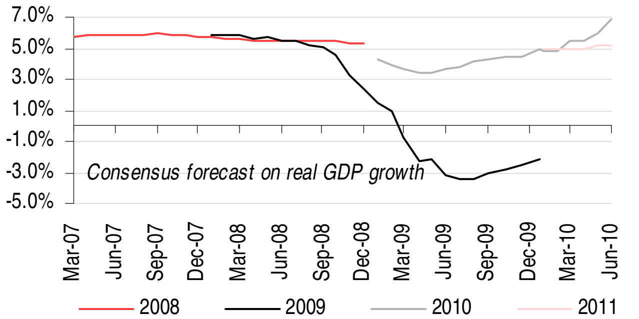
Source: HSBC

6. Earnings momentum



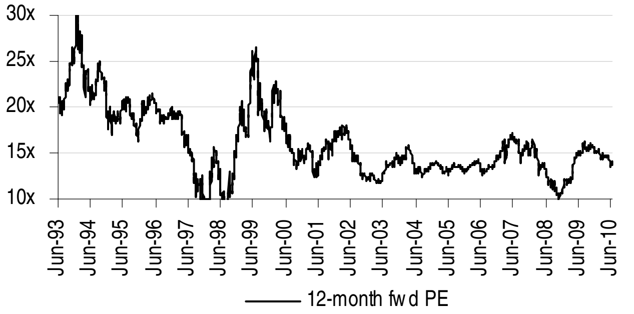
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



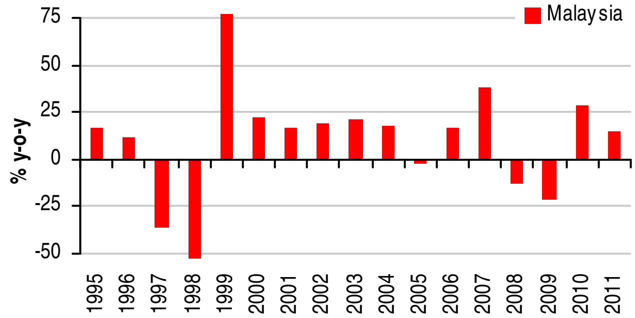
Source: Consensus Economics, HSBC

8. Valuation



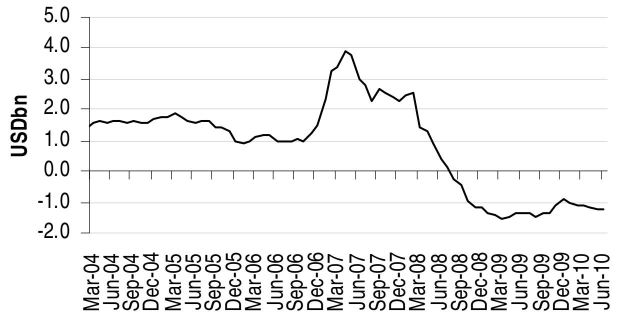
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

Indonesia

1. Return (%, USD)

	MSCI Indonesia	JSX
3-month	5.1	7.3
6-month	21.2	21.0
12-month	70.3	47.8
24-month	20.9	24.0

2. Valuation

	2010	2011
PE (X)	14.7	12.3
P/B (X)	3.7	3.1
Dividend yield (%)	2.8	3.4

3. Q2 2010 Sectors Performance %

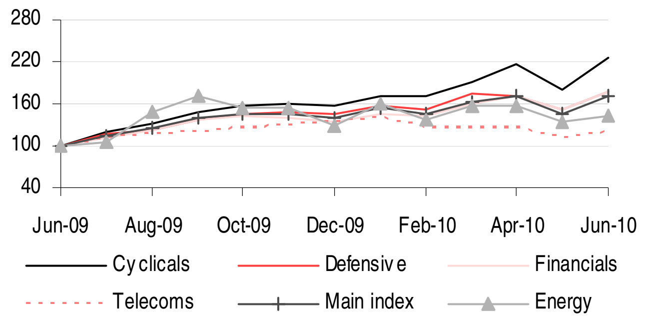
Sector	Perf	Sector	Perf
Consumer Discretionary	21.5	Telecom	-4.5
Financials	10.4	Utilities	-5.6
Materials	8.7	Energy	-8.0
Consumer Staples	7.4		

4. Earnings (%)

	2010	2011
Earnings growth (y-o-y)	21.0	19.8
ROE	24.8	25.4
ROA	7.5	10.4
Net debt/ equity ratio	14.9	6.0

Notes: Performance for Q2 2010 is up to 21 June 2010; ^^ for full explanatory notes, Valuation & Earnings tables, please see Datapack section on page 49; Source: HSBC, I/B/E/S

5. Market performance

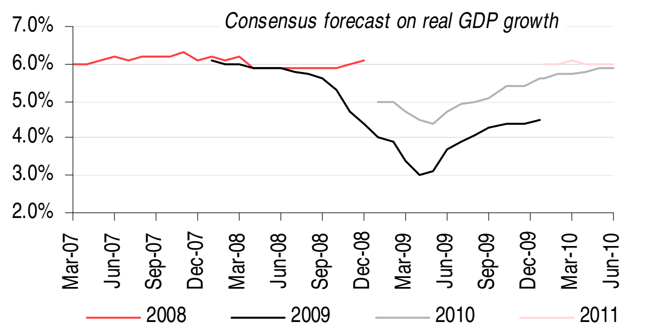


Source: HSBC

6. Earnings momentum

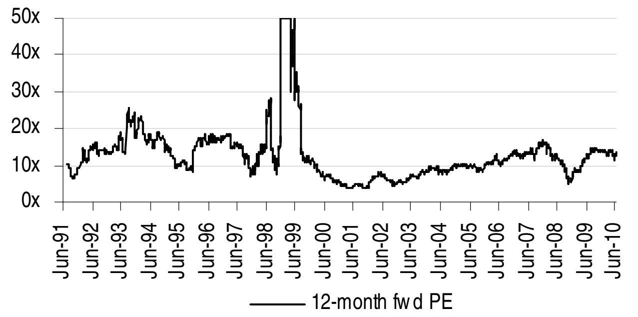
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



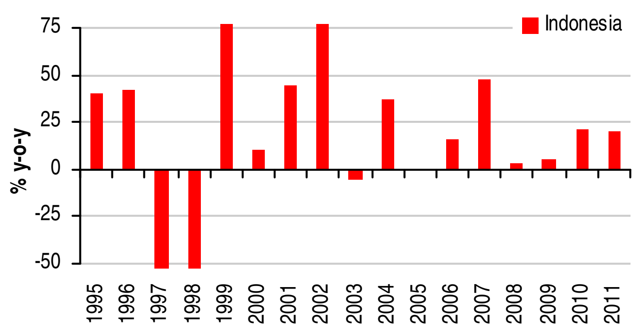
Source: Consensus Economics, HSBC

8. Valuation



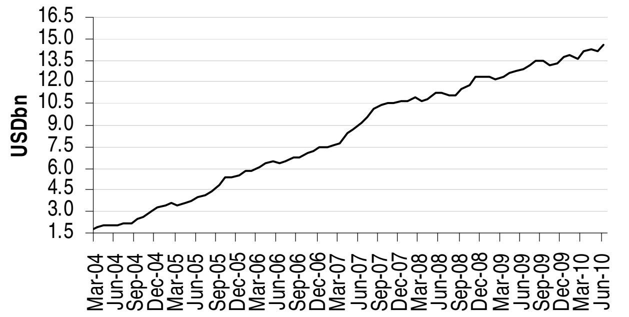
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

Thailand

1. Return (%, USD)

	MSCI Thailand	SET
3-month	1.9	4.1
6-month	16.0	12.7
12-month	37.1	36.9
24-month	6.6	4.8

2. Valuation

	2010	2011
PE (X)	11.7	9.9
P/B (X)	1.8	1.6
Dividend yield (%)	3.7	4.2

3. Q2 2010 Sectors Performance %

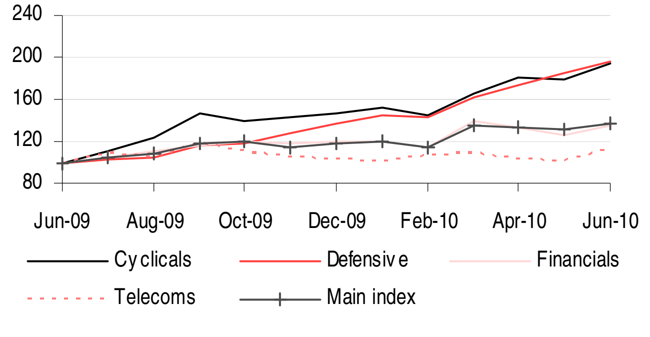
Sector	Perf	Sector	Perf
Consumer Staples	25.6	Energy	0.8
Materials	18.8	Utilities	-2.6
Consumer Discretionary	9.5	Financials	-3.7
Telecom	3.9		

4. Earnings (%)

	2010	2011
Earnings growth (y-o-y)	18.6	18.3
ROE	15.3	16.2
ROA	3.2	3.6
Net debt/ equity ratio	63.3	56.1

Notes: Performance for Q2 2010 is up to 21 June 2010; ^^ for full explanatory notes, Valuation & Earnings tables, please see Datapack section on page 49; Source: HSBC, I/B/E/S

5. Market performance

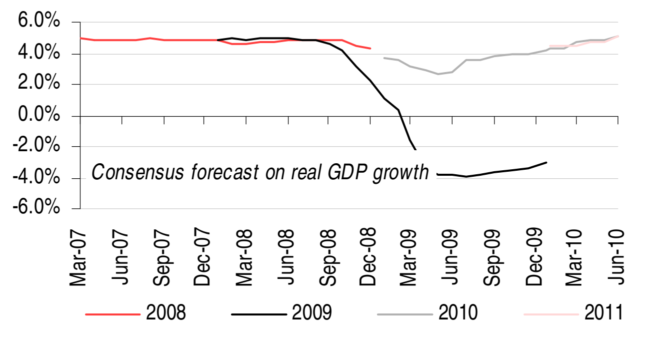


Source: HSBC

6. Earnings momentum

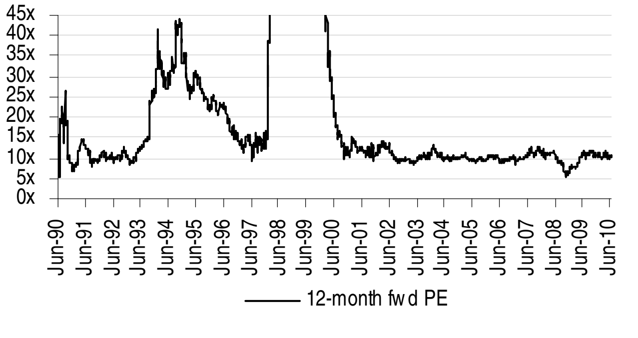
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



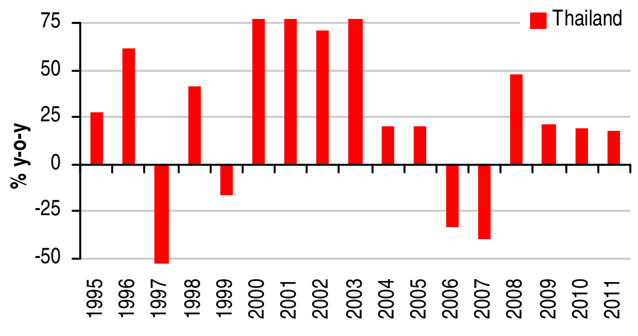
Source: I/B/E/S, HSBC

8. Valuation



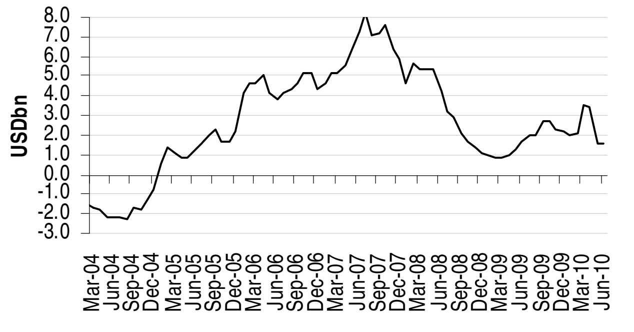
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

Philippines

1. Return (%, USD)

	MSCI Philippines	PSE
3-month	5.7	8.4
6-month	9.2	11.2
12-month	36.2	40.0
24-month	21.2	30.2

2. Valuation

	2010	2011
PE (X)	14.8	13.2
P/B (X)	2.4	2.2
Dividend yield (%)	3.3	3.6

3. Q2 2010 Sectors Performance %

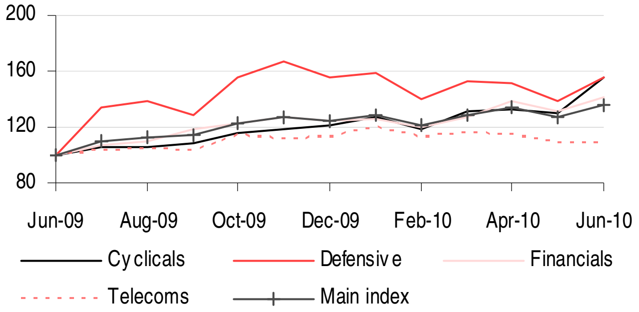
Sector	Perf	Sector	Perf
Consumer Discretionary	18.3	Utilities	1.9
Industrials	13.2	Telecom	-7.1
Financials	11.9		

4. Earnings (%)

	2010	2011
Earnings growth (y-o-y)	23.8	12.1
ROE	15.9	16.4
ROA	3.8	3.8
Net debt/ equity ratio	42.8	38.7

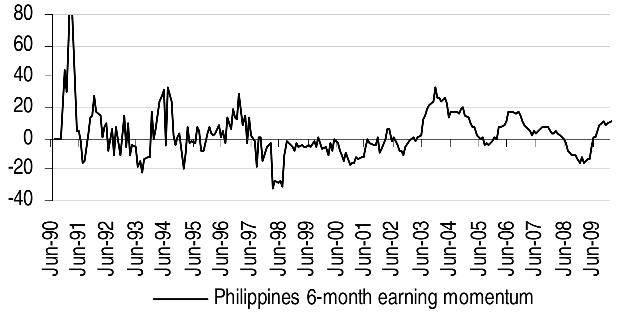
Notes: Performance for Q2 2010 is up to 21 June 2010 ; ^^ for full explanatory notes, Valuation & Earnings tables, please see Datapack section on page 49; Source: HSBC, I/B/E/S

5. Market performance



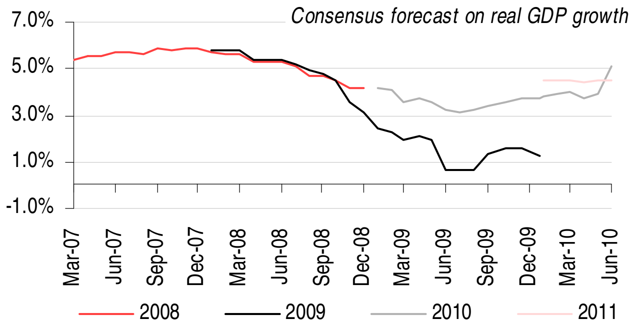
Source: HSBC

6. Earnings momentum



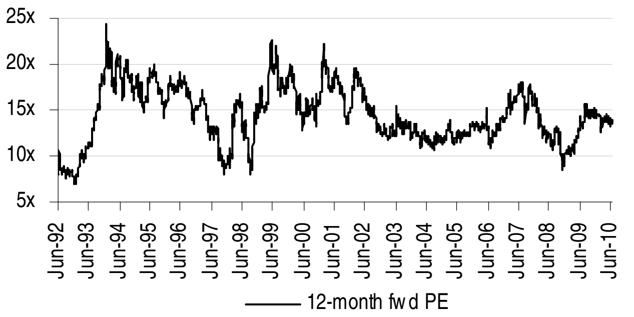
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



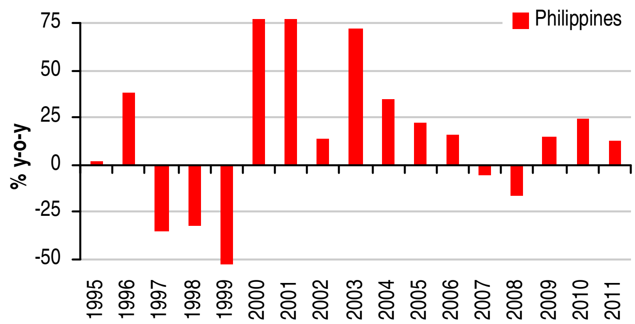
Source: Consensus Economics, HSBC

8. Valuation



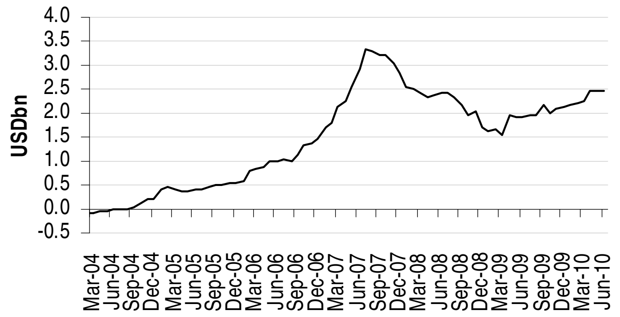
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

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HSBC

Datapack

Country/ Sector performance

MSCI indices performance (%)

By country/region

	Current level	1M	3M	6M	12M	24M
Asia Pacific	119	6.4	-4.6	1.3	17.4	-14.9
Asia Ex Japan	484	9.5	-0.9	3.7	28.2	-4.1
Australia	745	14.2	-9.6	-1.5	29.2	-17.7
China	63	10.2	-1.5	1.0	17.7	-1.2
Hong Kong	7,127	7.0	-5.2	1.3	16.9	-10.3
India	488	11.3	0.3	9.0	33.2	14.9
Indonesia	731	15.8	5.1	19.0	70.3	20.9
Japan	2,215	0.9	-6.3	-0.1	4.6	-23.3
Korea	335	11.1	0.4	5.7	42.2	-8.5
Malaysia	380	8.2	6.5	12.6	37.1	12.3
Philippines	287	7.5	5.7	9.0	36.2	21.2
Singapore	497	9.2	0.7	3.4	32.0	-7.6
Taiwan	244	6.5	-3.9	-2.4	24.2	-15.0
Thailand	254	4.6	1.9	14.1	37.1	6.6

Source: HSBC, Datastream Note: As of 21st June 2010

By Asia Pacific sector

	Current level	1M	3M	6M	12M	24M
Energy	527	10.1	-1.5	3.4	17.2	-16.6
Consumer Discretionary	135	3.2	-5.3	-0.2	18.9	-12.3
Automobiles & Components	177	2.0	-3.5	-2.0	19.4	-8.7
Consumer Durables & Apparel	95	0.7	-13.2	-4.1	5.8	-31.0
Consumer Services	154	11.4	3.6	7.2	24.4	-1.5
Media	114	3.8	-3.2	6.7	26.0	-4.2
Retailing	133	7.8	-3.8	8.4	37.6	8.4
Consumer Staples	154	9.0	-2.7	4.8	24.4	-0.9
Food & Staples Retailing	199	8.9	-4.1	8.4	20.8	-6.8
Food, Beverage & Tobacco	161	8.4	-3.8	0.9	24.5	-1.3
Household & Personal Products	164	11.4	5.1	10.6	34.6	19.0
Financials	141	6.4	-5.9	-1.4	11.9	-18.7
Banks	134	7.4	-5.0	1.1	16.0	-14.2
Diversified Financials	114	3.0	-10.8	-7.5	-3.6	-32.8
Insurance	141	2.3	-7.6	-6.7	11.2	-20.7
Real Estate	149	7.9	-5.1	-2.0	9.4	-21.8
Health Care	155	4.4	-7.9	-3.4	9.7	-13.2
Health Care Equipment & Services	207	5.0	-6.5	-9.4	22.4	-9.5
Pharmaceuticals, Biotechnology & Life Sciences	147	4.3	-8.3	-1.8	7.3	-14.0
Industrials	147	6.0	-4.8	3.8	14.7	-20.8
Capital Goods	172	6.4	-5.6	3.7	17.2	-21.9
Commercial Services & Supplies	69	-1.5	-10.6	-8.0	2.1	-18.8
Transportation	134	6.0	-1.5	6.2	10.5	-18.1
Information Technology	158	5.7	-2.6	4.0	34.1	-8.2
Software & Services	207	7.0	-1.0	11.8	36.0	-6.2
Technology Hardware & Equipment	145	3.0	-4.2	1.8	28.2	-13.0
Semiconductors & Semiconductor Equipment	183	9.6	-0.9	3.4	43.8	-0.4
Materials	277	10.0	-7.3	-1.5	21.5	-21.0
Telecommunication Services	72	6.5	0.2	6.2	7.3	-15.4
Utilities	138	4.4	-1.8	4.8	9.7	4.6

Source: HSBC, Datastream Note: As of 21st June 2010

HSBC

Local indices performance (%)

By country

	Current level	1M	3M	6M	12M	24M
Australia (S&P/ASX 200)	4,613	7.1	-5.3	-2.0	18.3	-12.8
China (Hand Seng China Enterprise)	12,134	9.8	-1.0	-1.7	15.5	-1.7
Hong Kong (Hang Seng)	20,912	7.0	-2.2	-0.9	16.7	-8.1
India (Sensex)	17,877	8.7	1.7	7.1	23.1	22.7
Indonesia (Jakarta Composite)	2,942	12.1	7.3	19.2	47.8	24.0
Japan (TOPIX)	902	2.6	-4.9	-0.1	-1.8	-33.5
Korea (KOSPI)	1,740	8.7	3.2	5.1	25.8	0.5
Malaysia (KLCI)	1,335	3.9	3.0	5.9	26.0	10.7
Philippines (PSEi)	3,358	5.6	8.4	11.3	40.0	30.2
Singapore (STI)	2,886	6.8	-1.0	2.2	26.9	-3.9
Taiwan (Taiwan SE Weighted)	7,636	5.5	-3.3	-2.8	22.5	-3.4
Thailand (SET)	806	5.3	4.1	11.3	36.9	4.8

Source: HSBC, Datastream Note: As of 21st June 2010

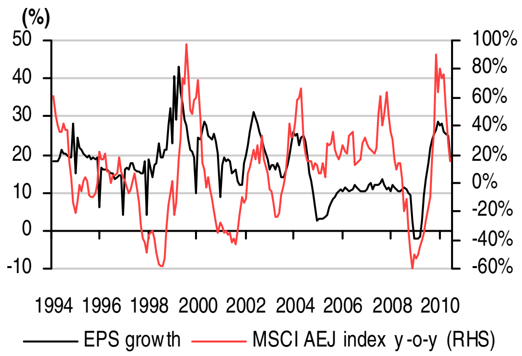
By Asia ex Japan sectors

	Current level	1M	3M	6M	12M	24M
Energy	717	10.0	0.6	5.0	24.3	-10.6
Consumer Discretionary	432	12.8	5.2	12.9	58.9	25.6
Automobiles & Components	505	12.2	15.2	23.3	101.2	85.1
Consumer Durables & Apparel	420	7.2	-6.9	-4.1	18.5	-14.2
Consumer Services	151	14.3	2.9	5.7	27.3	-6.6
Media	115	5.7	-4.5	4.0	30.8	-20.5
Retailing	305	15.3	-3.8	8.4	52.2	3.9
Consumer Staples	338	13.1	2.9	8.3	41.5	7.3
Food & Staples Retailing	461	12.1	-6.4	4.1	31.0	-4.1
Food, Beverage & Tobacco	262	12.7	-0.5	4.2	36.7	1.6
Household & Personal Products	2,573	18.7	17.7	24.3	84.9	86.5
Financials	274	9.0	-1.1	0.9	22.1	-1.4
Banks	215	11.0	-4.0	2.2	33.2	2.8
Diversified Financials	297	7.8	-7.7	-5.4	9.6	-10.6
Insurance	149	7.1	-7.3	-8.0	22.2	-8.6
Real Estate	149	12.0	-4.4	-1.0	16.4	-17.3
Health Care	476	7.9	1.4	6.2	39.9	-0.5
Health Care Equipment & Services	222	10.7	-6.6	-6.1	23.4	-3.5
Pharmaceuticals, Biotechnology & Life Sciences	859	12.2	-8.7	6.7	16.4	-22.7
Industrials	167	10.7	-4.0	5.1	19.1	-20.0
Capital Goods	136	10.8	-6.2	1.9	16.4	-27.2
Commercial Services & Supplies	51	-6.1	-22.1	-11.1	8.4	-28.2
Transportation	196	10.0	-5.2	3.5	24.5	-18.7
Information Technology	239	7.8	-2.4	2.0	45.6	2.8
Software & Services	202	-0.9	-8.5	-5.9	34.6	41.9
Technology Hardware & Equipment	188	5.7	-4.1	-0.8	40.1	-3.8
Semiconductors & Semiconductor Equipment	216	10.5	-0.3	3.8	46.8	0.3
Materials	360	11.3	-5.0	-0.5	32.6	-10.2
Telecommunication Services	120	8.2	1.7	8.2	7.1	-20.3
Utilities	181	5.6	0.1	6.5	14.3	-0.1

Source: HSBC, Datastream Note: As of 21st June 2010

Earnings

1. 12-month forward EPS growth vs MSCI Asia ex Japan



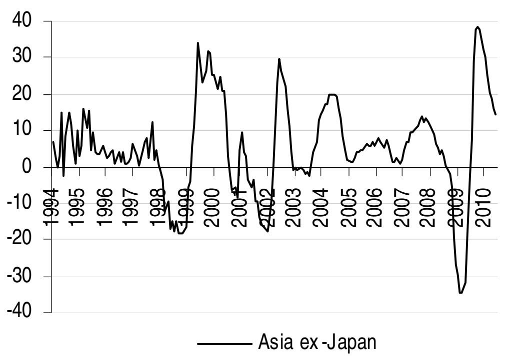
Source: Bloomberg, I/B/E/S, HSBC

2. Consensus forecast for EPS growth

	2009	2010	2011
Australia	-5.9	16.0	17.4
China	11.9	24.9	16.6
Hong Kong	-6.6	23.7	8.9
India	12.4	27.4	21.7
Indonesia	5.2	21.0	19.8
Japan	-0.9	170.6	30.5
Korea	55.3	50.9	6.3
Malaysia	-21.3	28.5	15.1
Philippines	14.7	23.8	12.1
Singapore	-12.2	20.6	10.5
Taiwan	55.9	89.7	12.9
Thailand	21.1	18.6	18.3
Asia ex-Japan	**16.9**	**37.1**	**12.7**
Asia Pacific	**84.1**	**44.8**	**17.7**

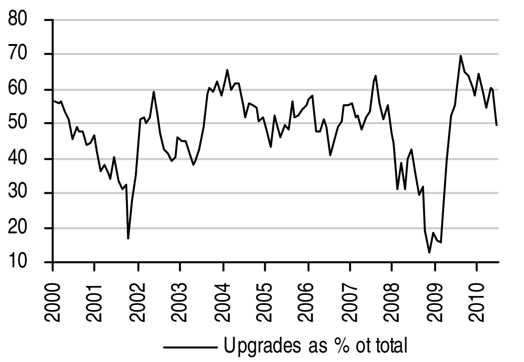
Source: I/B/E/S, HSBC

3. Earnings momentum – Asia ex Japan



Source: I/B/E/S, HSBC

4. Upgrades as % of total earnings revisions – Asia Pacific



Source: I/B/E/S, HSBC

5. Revisions to 2010 EPS forecasts by country

Country	vs 3M ago	Rank	vs 6M ago	Rank
JP	**90.6%**	1	**8.7%**	4
TW	**8.8%**	2	**20.0%**	1
KR	**7.7%**	3	**12.4%**	2
AU	**3.0%**	4	**9.9%**	3
PH	**2.1%**	5	**3.7%**	9
TH	**2.0%**	6	**4.6%**	8
SG	**1.2%**	7	**5.7%**	6
ID	**1.1%**	8	**4.7%**	7
HK	**1.0%**	9	**6.7%**	5
MY	**0.9%**	10	**2.5%**	10
CN	**0.3%**	11	**-0.1%**	12
IN	**-0.1%**	12	**0.8%**	11
AEJ	**0.6%**		**5.3%**	
AP	**0.3%**		**5.3%**	

Source: I/B/E/S, HSBC

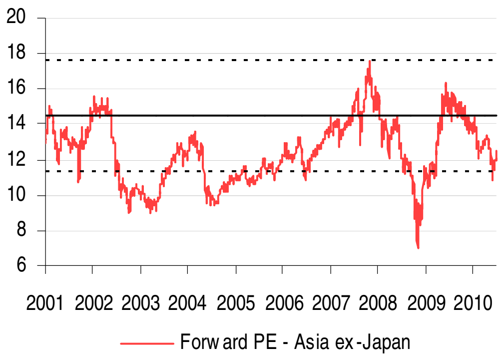
6. Revisions to 2010 EPS forecasts for Asia Pacific sectors

Sector	vs 3M ago	Rank	vs 6M ago	Rank
IT	**7.5%**	1	**21.3%**	1
Energy	**7.1%**	2	**7.9%**	5
Industrials	**5.8%**	3	**13.5%**	3
Materials	**5.2%**	4	**16.3%**	2
Cons. discr	**0.1%**	5	**9.7%**	4
Telco	**-2.6%**	6	**-2.9%**	6
Financials	**-4.9%**	7	**-3.5%**	7
Cons. stap	**-5.4%**	8	**-4.7%**	8
Health care	**-7.3%**	9	**-11.9%**	9
Utilities	**-11.7%**	10	**-13.8%**	10
Asia Pac	**0.3%**		**5.3%**	

Source: I/B/E/S, HSBC

Valuation

1. 12-month forward PE – Asia ex Japan



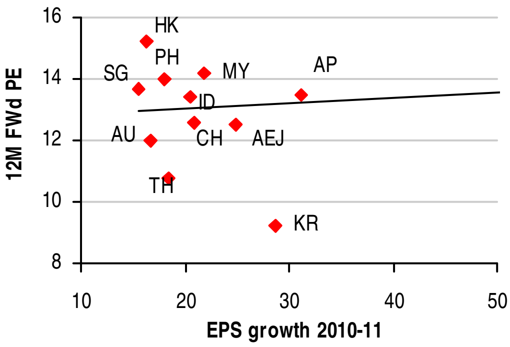
Source: Bloomberg. I/B/E/S, HSBC

2. Current forward PE versus historical average

	PE now	Average 2001–	% diff	Average 1993–	% diff
China	12.6	12.9	-3%	13.2	-5%
HK	15.2	15.9	-4%	14.9	2%
India	16.3	14.0	16%	13.7	18%
Indonesia	13.4	9.6	40%	12.8	5%
Korea	9.2	9.2	0%	11.2	-18%
Malaysia	14.2	14.1	0%	16.0	-12%
Philippines	14.0	13.9	0%	14.7	-5%
Singapore	13.7	14.7	-7%	16.2	-16%
Taiwan	12.3	14.5	-15%	18.3	-33%
Thailand	10.8	10.4	3%	20.1	-46%
Japan	15.3	19.4	-21%	30.7	-50%
Australia	12.0	14.4	-17%	14.9	-19%
Asia ex-Japan	**12.5**	**12.5**	**0%**	**14.4**	**-14%**
Asia Pacific	**13.5**	**16.0**	**-16%**	**24.9**	**-46%**

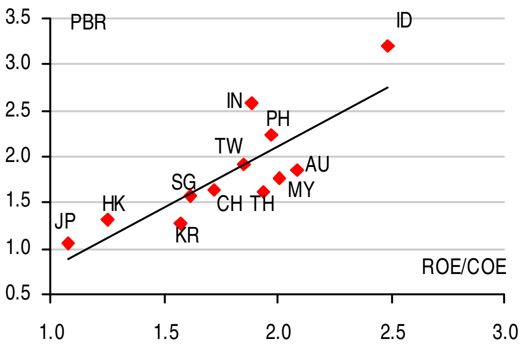
Source: Bloomberg, I/B/E/S, HSBC

3. PE versus average EPS growth 2010-11



Source: I/B/E/S, HSBC ;Note- Japan with EPS growth of 100.5% and PE of 15.3x has been omitted from above chart

4. PB versus ROE/ COE



Source: Bloomberg, I/B/E/S, HSBC

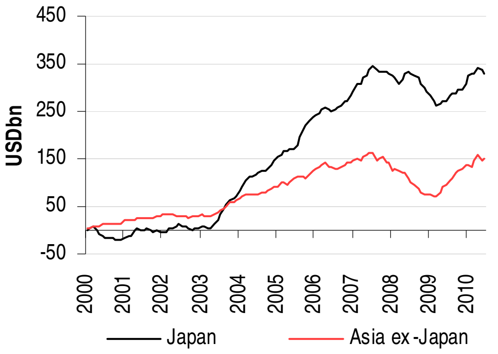
5. Dividend discount model

	MY	SG	CH	HK	TH	TW	PH	JP	IN	AU	KR	ID
Inputs												
DPS year 1	16.6	56.1	1.8	338.8	13.0	12.1	21.6	11.7	8.9	43.5	7.5	125.0
EPS year 1	33.7	118.7	5.0	658.9	31.0	22.2	45.1	36.6	47.2	78.7	54.5	304.4
EPS year 2	37.9	130.0	5.8	731.7	35.9	24.6	50.5	43.6	56.6	88.0	58.4	352.4
Growth in stage 2 (%)	8.0	8.0	12.0	7.0	9.0	9.0	9.0	6.0	12.0	7.0	8.0	12.0
No. of years of excess growth	10	10	12	10	10	10	10	10	12	10	10	12
Perpetual growth rate (%)	6	6	6	6	6	6	6	4	6	6	6	6
Payout ratio now (%)	49.2	47.2	35.5	51.4	42.1	54.5	48.0	31.9	18.8	55.3	13.8	41.1
Payout ratio at end stage 2 (%)	40	50	40	50	40	45	45	50	40	55	40	40
COE (%)	7.0	7.5	9.0	7.5	8.5	8.5	8.5	6.5	9.5	9.6	9.5	10.5
Result												
MSCI index now	477	1,575	59	9,648	319	261	618	514	707	870	470	3,887
Fair value	1,981	4,623	144	23,741	769	570	1,142	911	1,076	1,276	675	5,504
Under/over valued (%)	-75.9	-65.9	-59.1	-59.4	-58.5	-54.2	-45.9	-43.6	-34.2	-31.8	-30.3	-29.4

Source: HSBC

Supply & demand

1. Cumulative net buying by foreign investors since 2000



Source: Bloomberg, HSBC

2. Foreign net buying by markets, 2009-10

(USDbn)	JP	TW	KR	TH	IN	ID
May-09	5.9	1.9	3.2	0.2	4.2	0.2
Jun-09	0.0	0.7	2.0	0.4	0.7	0.1
Jul-09	10.6	2.6	4.7	0.3	2.4	0.3
Aug-09	6.1	0.3	3.0	0.1	0.8	0.2
Sep-09	-1.6	4.4	4.0	0.7	4.1	0.1
Oct-09	8.3	-0.4	1.3	0.0	1.8	-0.3
Nov-09	0.3	0.7	1.6	-0.4	1.2	0.2
Dec-09	12.9	3.1	1.9	-0.1	2.2	0.4
2009	**17.1**	**14.8**	**24.8**	**1.1**	**17.6**	**1.4**
Jan-10	17.5	0.1	0.6	-0.2	-0.2	0.0
Feb-10	3.0	-2.8	0.0	0.2	0.5	-0.2
Mar-10	0.9	3.6	4.7	1.4	4.1	0.5
Apr-10	13.8	3.7	4.6	-0.1	2.2	0.2
May-10	-6.6	-4.0	-5.4	-1.8	-2.0	-0.2
Jun-10	-9.3	0.9	1.1	0.0	1.1	0.4

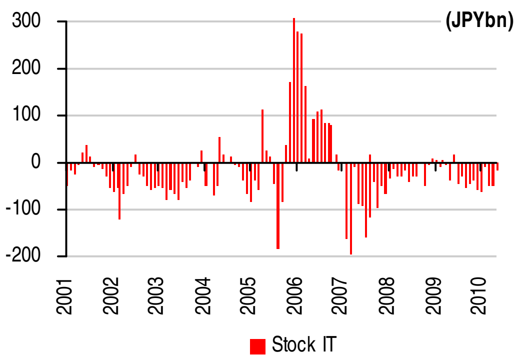
Source: Bloomberg, HSBC Note: Jun-10 data up to 21st June 2010

3. Total equity issuance by market 2007-10

(USDbn)	2007	2008	2009	2010	2010* v 2009
AU	23.3	33.4	51.1	5.1	-79%
CH	53.1	34.9	77.7	37.2	2%
HK	20.7	4.5	13.5	5.0	-21%
IN	24.3	13.3	18.1	12.1	42%
JP	19.5	9.5	58.4	30.4	10%
KR	10.1	2.8	8.8	10.0	141%
MY	3.1	0.9	5.1	1.9	-21%
SG	6.1	1.5	8.5	1.8	-55%
TH	0.6	0.7	0.4	0.1	-30%
TW	8.9	1.3	3.2	0.6	-59%
AEJ	**158.0**	**101.4**	**190.1**	**78.0**	**-13%**
AP	**177.6**	**110.9**	**248.6**	**108.3**	**-8%**

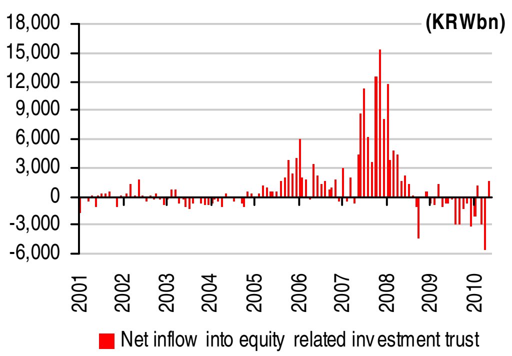
Notes: 2010 y-t-d data up to 21 June 2010 * = annualized
Source: Bloomberg, HSBC

4. Net inflows into Japanese equity investment trusts



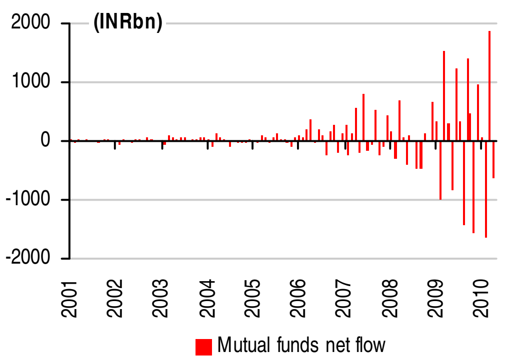
Source: IT association, HSBC

5. Net inflows in to Korean equity-related investment trusts



Source: CEIC, HSBC

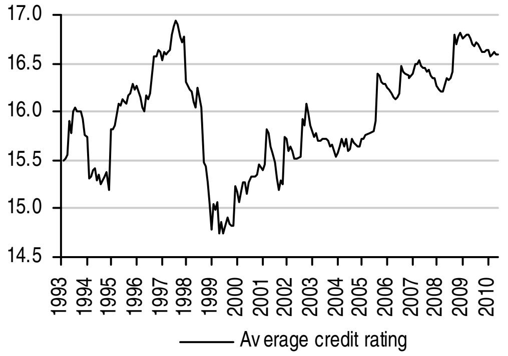
6. Net inflows into Indian mutual funds



Source: CEIC, HSBC

Politics and risk

1. Average sovereign credit rating – Asia ex Japan



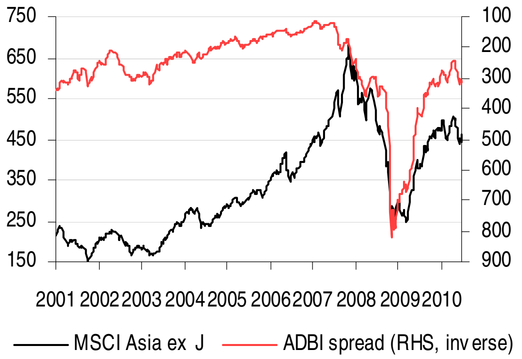
Source: Bloomberg. HSBC

2. S&P long-term foreign currency credit ratings

	Latest rating	Date	Previous rating
AU	AAA	Feb-03	AA+
SG	AAA	Mar-95	AA+
HK	AA+	Jul-08	AA
JP	AA	Apr-07	AA-
TW	AA-	Dec-02	AA
CH	A+	Jul-08	A
KR	A	Jul-05	A-
MY	A-	Oct-03	BBB+
TH	BBB+	Oct-06	BBB+
IN	BBB-	Jan-07	BB+
ID	BB	Mar-10	BB-
PH	BB-	Jan-05	BB
VN	BB	Sep-06	

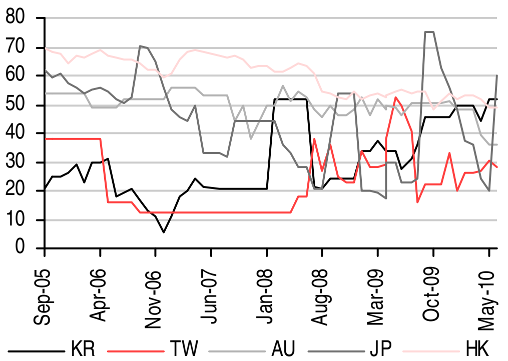
Source: Bloomberg

3. Spread on Asian USD bonds versus MSCI Asia ex Japan



Source: I/B/E/S, HSBC

4. Government approval ratings



Source: Bloomberg, I/B/E/S, HSBC

5. Political snapshot of Asia Pacific markets

Country	Head of government	Latest approval rating	Next significant political events
Australia	Julia Gillard (PM)	-	Next Australian Federal Election to be held in 2011
China	Hu Jintao (President)	-	Next Presidential election to be held in late 2012 to early 2013
Hong Kong	Donald Tsang (Chief Executive)	49%	-Next Legislative election presumably to be held in September 2012
India	Manmohan Singh (PM)	70%	Next Presidential elections to be held by July 2012 and General elections by 2014
Indonesia	Susilo Bambang Yudhoyono (President)	-	Next Presidential election to be held in 2014
Japan	Naoto Kan(PM)	60%	Next election to be held in July 11 2010
Korea	Lee Myung-bak (President)	52%	Next Presidential and National Assembly elections to be held by 2012
Malaysia	Mohamed Najib bin Abdul Razak (PM)	72%	Next House of Representatives by June 2013
Philippines	Mr Benigno Aquino III (President)	-	Next Presidential, legislative and local elections in 2016
Singapore	Lee Hsien Loong (PM)	-	Next Parliamentary and Presidential elections by 2011
Taiwan	Ma Ying-jeou (President)	28%	Next Mayoral elections in November 2010 and general elections in 2012
Thailand	Abhisit Vejjajiva (PM)	-	Next Election to be held in 2011

Source: Various polling agencies and media, HSBC

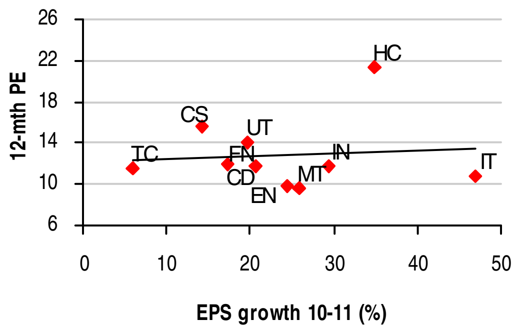
Sectors and stocks

2. MSCI Asia Pacific sector performance (2Q)

%	3M	Y-t-d	3M relative	Y-t-d relative	Weight*
Telecom	0.2	4.2	4.8	5.3	4.7
Energy	-1.5	-0.5	3.1	0.6	5.0
Utilities	-1.8	4.4	2.8	5.5	4.3
Information Technology	-2.6	0.8	2.0	1.9	14.1
Consumer staples	-2.7	1.9	1.9	2.9	5.8
Industrials	-4.8	2.4	-0.2	3.5	13.3
Consumer durables	-5.3	-1.6	-0.7	-0.5	11.7
Financials	-5.9	-3.8	-1.3	-2.7	27.5
Materials	-7.3	-5.1	-2.7	-4.1	10.5
Health Care	-7.9	-3.7	-3.3	-2.7	3.1
MSCI Asia-Pacific	**-4.6**	**-1.1**			

Notes: * = in MSCI Asia Pacific; 3M and y-t-d data up to 21 June 2010
Source: Bloomberg, HSBC

3. PE vs 2010-11 growth, Asia ex-Japan sectors



Source: I/B/E/S, HSBC

4. Consensus EPS growth (%) by sector

	Asia Pacific 2010	Asia Pacific 2011	Asia ex-Japan 2010	Asia ex-Japan 2011
Consumer disc	116.1	28.9	21.2	13.1
Technology	113.6	12.9	86.8	7.2
Industrials	82.8	18.0	44.2	14.4
Materials	51.8	27.3	39.6	12.1
Energy	41.6	9.8	32.3	16.7
Financials	15.2	15.7	25.2	16.1
Consumer staples	13.2	16.4	14.8	13.5
Telecoms	6.8	5.8	5.4	6.5
Utilities	-2.1	35.3	24.0	15.3
Health Care	-6.4	7.7	46.3	23.2

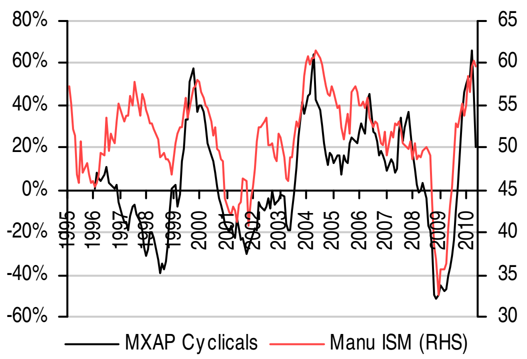
Source: I/B/E/S

5. Consensus PE (x)

	Asia Pacific 2010	Asia Pacific 2011	Asia ex-Japan 2010	Asia ex-Japan 2011
Utilities	19.8	14.7	15.2	13.2
Consumer staples	17.6	15.1	16.9	14.9
Health Care	16.6	15.4	23.4	19.0
Consumer disc	16.2	12.6	12.7	11.2
Industrials	13.3	11.2	12.6	11.0
Financials	13.1	11.3	12.7	10.9
Technology	13.1	11.6	11.2	10.5
Materials	12.0	9.5	10.2	9.1
Energy	11.4	10.4	10.7	9.2
Telecoms	11.3	10.7	12.0	11.3

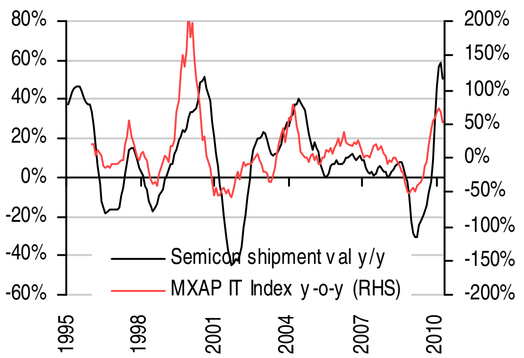
Source: I/B/E/S

6. MSCI Asia Pacific cyclical sectors vs Manufacturing ISM index



Source: HSBC, Bloomberg

7. Semiconductor shipment vs MSCI Asia Pacific IT sector



Source: WSTS, Bloomberg

Scorecards

8. Asia ex-Japan

	Price momentum			Earnings momentum			Valuation			Consolidated		
	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg
Consumer Staples	4	0	-1	1	7	0	6	0	0	1	7	0
Consumer Discretionary	1	1	3	1	0	4	10	0	-1	2	-1	4
Telecommunication Services	6	1	2	5	3	3	1	1	1	2	4	4
Energy	5	3	4	6	0	3	3	0	0	4	2	6
Health Care	2	-1	3	8	2	2	5	0	-1	5	0	3
Utilities	3	0	4	9	-2	-2	3	0	2	5	-4	3
Materials	10	0	-9	3	0	2	7	0	0	7	3	-5
Financials	8	1	2	10	-6	-7	2	-1	-1	7	-4	-3
Industrials	9	-4	-3	3	1	-2	9	0	0	9	-1	-4
Information Technology	7	-1	-5	7	-6	-4	8	-1	0	10	-7	-8

Source: HSBC

9. Australia

	Price momentum			Earnings momentum			Valuation			Consolidated		
	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg
Utilities	2	-1	1	1	7	6	5	0	0	1	3	5
Consumer Staples	1	3	0	4	0	1	4	0	-1	2	0	-1
Consumer Discretionary	9	-5	1	2	5	4	1	0	0	3	-1	4
Materials	5	4	-4	2	0	1	6	1	1	4	5	-2
Telecommunication Services	7	-3	0	6	3	3	2	0	0	5	0	3
Financials	8	-6	-2	5	-4	-3	3	0	1	6	-5	-3
Health Care	2	2	1	9	-3	-5	6	-1	-1	7	-2	-4
Energy	5	5	4	6	4	4	9	-1	-1	8	2	2
Information Technology	4	-2	-1	8	-4	-7	8	1	1	8	-3	-3
Industrials	10	-2	-3	9	-6	-1				10	-2	-1

Source: HSBC

10. China

	Price momentum			Earnings momentum			Valuation			Consolidated		
	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg
Telecommunication Services	1	1	9	5	1	4	2	0	1	1	0	8
Consumer Staples	2	1	-1	2	2	1	7	0	-3	2	2	-1
Industrials	9	-2	-3	1	1	4	3	0	2	3	-1	3
Financials	3	6	2	7	-1	-2	4	-1	-2	4	3	-1
Utilities	7	-1	2	6	4	4	1	0	0	4	2	4
Energy	6	-1	-2	4	-1	-2	5	0	2	6	-3	-2
Consumer Discretionary	3	4	-2	7	-2	-2	8	0	1	7	2	-2
Information Technology	7	-3	-6	2	-1	-1	9	0	-1	7	-3	-5
Health Care	3	-2	4	9	-1	-1	10	0	0	9	-1	1
Materials	10	0	-2	10	-2	-6	6	-1	-1	10	0	-3

Source: HSBC

11. Hong Kong

	Price momentum			Earnings momentum			Valuation			Consolidated		
	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg
Utilities	2	1	1	2	2	-1	2	0	0	1	1	0
Consumer Discretionary	3	-1	-2	2	4	4	3	0	0	2	2	2
Industrials	4	-1	2	1	1	2	4	0	0	3	-1	2
Telecommunication Services	1	0	6	2	2	1	6	0	0	3	1	4
Financials	4	1	-1	6	-4	-3	1	0	0	5	-4	-3
Information Technology	6	-1	-4	2	-1	-1	5	0	0	6	-2	-3
Energy	7	0	-2							7	0	-1

Source: HSBC

12. India

	Price momentum			Earnings momentum			Valuation			Consolidated		
	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg
Consumer Discretionary	1	0	1	1	0	0	5	-1	0	1	0	1
Health Care	3	1	-1	5	-1	-2	1	0	1	2	0	-1
Energy	5	4	3	6	4	4	1	1	0	3	6	4
Materials	7	-3	-6	2	0	2	4	2	2	4	-1	0
Consumer Staples	3	4	4	9	-2	-2	3	0	0	5	0	0
Information Technology	2	0	0	6	-3	-4	7	0	-1	5	-2	-2
Industrials	9	-5	-4	3	2	1	8	0	0	7	-2	-2
Financials	7	-4	-2	4	2	2	9	0	0	7	0	1
Telecommunication Services	5	5	5	9	0	0				9	1	1
Utilities	10	-2	-1	8	-1	0	5	0	-2	10	-2	-2

Source: HSBC

13. Japan

	Price momentum			Earnings momentum			Valuation			Consolidated		
	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg
Industrials	3	0	-1	3	-1	-1	5	0	0	1	0	1
Energy	1	0	9	1	0	9	10	0	0	2	0	8
Information Technology	2	0	-1	7	-3	-6	6	0	0	3	-1	-2
Telecommunication Services	9	0	-2	4	5	4	2	0	0	3	7	3
Materials	5	-1	1	2	0	3	9	0	0	5	-1	3
Consumer Staples	6	-1	-2	6	1	1	4	0	0	5	0	0
Financials	4	2	5	7	-1	-1	7	0	0	7	0	2
Utilities	7	1	-2	9	0	-7	3	-1	-1	8	-1	-6
Consumer Discretionary	8	-1	-5	5	0	-3	7	0	0	9	-2	-5
Health Care	10	0	-2	10	-3	-2	1	0	0	10	-4	-4

Source: HSBC

14. Korea

	Price momentum			Earnings momentum			Valuation			Consolidated		
	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg
Energy	7	0	-5	2	5	7	2	0	2	1	5	4
Information Technology	2	0	2	1	0	1	8	0	1	1	1	4
Consumer Discretionary	1	3	4	3	-1	-2	10	-2	-4	3	1	-1
Consumer Staples	3	6	3	7	3	-2	4	0	-1	3	6	0
Health Care	4	-2	2	4	0	4	6	0	1	3	0	6
Telecommunication Services	6	-5	2	9	-3	-2	1	0	0	6	-5	1
Materials	8	-1	-7	4	-1	-1	5	0	0	7	-2	-6
Utilities	4	1	4	10	-1	-6	3	0	-1	7	0	-4
Financials	10	0	0	4	1	2	7	1	2	9	0	1
Industrials	8	-2	-6	7	0	2	8	-1	0	10	-2	-2

Source: HSBC

15. Singapore

	Price momentum			Earnings momentum			Valuation			Consolidated		
	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg
Industrials	1	0	0	1	0	0	1	0	2	1	0	0
Telecommunication Services	1	2	3	5	0	0	1	2	1	2	2	2
Consumer Discretionary	3	-1	2	3	-1	0	4	0	0	3	-1	2
Financials	4	-1	-2	3	1	-1	3	-2	-2	3	-1	-2
Consumer Staples	4	-1	-2	2	1	1	5	0	0	5	-1	-2

Source: HSBC

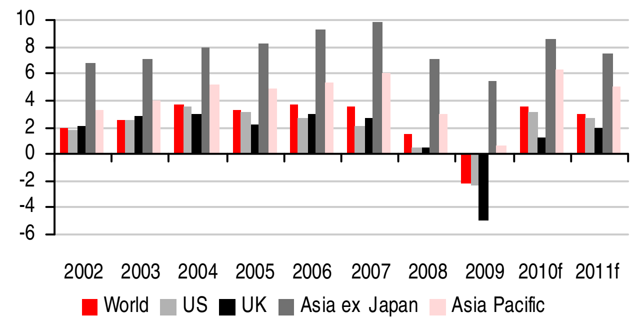
16. Taiwan

	Price momentum			Earnings momentum			Valuation			Consolidated		
	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg
Industrials	1	5	1	2	-1	0				1	3	0
Consumer Staples	2	3	0	1	1	7	3	0	1	2	0	4
Materials	6	-2	-5	5	-1	2	1	1	1	3	-1	-1
Consumer Discretionary	2	4	0	4	3	-1	6	0	0	3	5	1
Information Technology	7	-6	-2	3	0	0	3	0	-1	5	-4	-3
Telecommunication Services	2	-1	5	7	1	-1	5	0	0	6	-1	2
Energy	2	1	4	6	-1	-5	7	0	0	7	0	-1
Financials	8	0	0	7	-2	-4	2	-1	-1	8	-3	-3

Source: HSBC

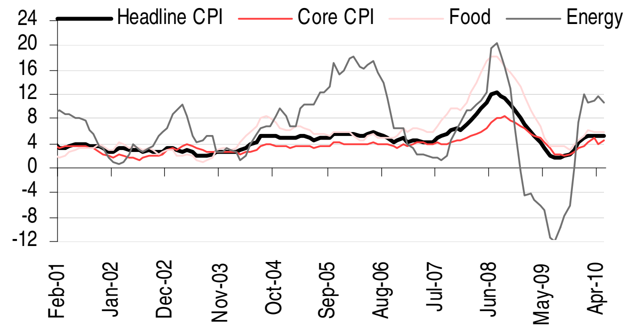
Economic forecasts

1. GDP growth, World, US, UK, and Asia ex Japan



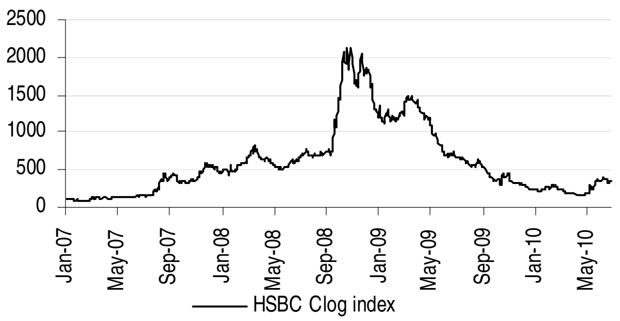
Source: HSBC

2. Asia ex Japan CPI breakdown



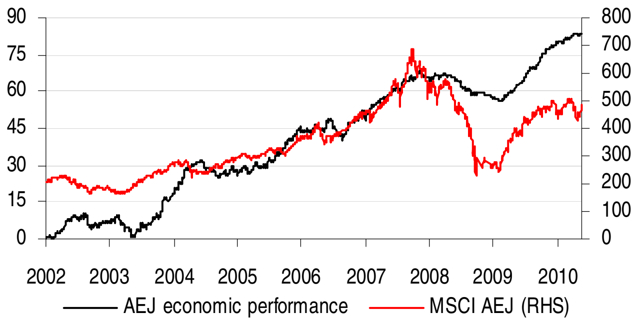
Source: HSBC

3. HSBC Clog index



Source: HSBC

4. Leading eco indicators for Asia ex Japan



Source: HSBC

HSBC Economic Forecasts

	Real GDP (% yr)		CPI (avg, % yr)		Exchange rate (yr end, %)		Long rates (yr end, %)		Short rates (avg, %)	
	2010e	2011e	2010e	2011e	2010e	2011e	2010e	2011e f	2010e	2011e
China	10.0	8.9	3.1	2.5	6.8	6.6	6.5	6.5	2.3	2.3
Hong Kong	5.4	4.7	2.4	3.4	7.8	7.8	2.1	2.7	0.3	1.4
India	8.8	8.3	10.2	4.7	45.5	43.5	8.5	8.0	5.0	6.0
Indonesia	6.0	6.0	4.6	6.0	8,900	8,800	10.3	10.5	7.6	7.6
Korea	5.8	4.3	2.7	3.1	1150	1100	5.2	5.8	3.3	4.3
Malaysia	7.1	5.2	2.0	2.6	3.2	3.2	4.7	4.5	2.5	3.0
Philippines	5.0	4.6	4.7	4.6	44.0	41.5	8.5	8.5	5.0	5.3
Singapore	9.7	5.5	2.5	3.0	1.4	1.3	2.3	2.5	0.7	1.1
Taiwan	7.3	4.9	1.1	2.2	31.5	30.0	1.4	2.1	0.9	1.3
Thailand	6.1	4.7	3.5	3.7	31.5	30.5	4.5	4.5	2.1	2.6
Japan	3.0	1.0	-1.0	-0.4	100	105	1.3	1.3	0.3	0.3
Vietnam	7.2	6.2	8.9	8.4	19,800	19,800	14.0	12.0		
Australia	2.8	2.7	3.0	2.7	0.9	0.9			4.8	5.1
Asia ex Japan	**8.6**	**7.5**	**4.2**	**3.3**						
Asia Pacific	**6.3**	**5.0**	**2.4**	**2.1**						

Source: HSBC

Notes

Disclosure appendix

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Issuer of report
The Hongkong and Shanghai Banking Corporation Limited
Level 19, 1 Queen's Road Central
Hong Kong SAR
Telephone: +852 2843 9111
Telex: 75100 CAPEL HX
Fax: +852 2596 0200
Website: www.research.hsbc.com

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Global Equity Strategy Research Team

Global

Garry Evans
Global Head of Equity Strategy
+852 2996 6916 garryevans@hsbc.com.hk

Europe

Robert Parkes
+44 20 7991 6716 robert.parkes@hsbcib.com

CEEMEA

John Lomax
+44 20 7992 3712 john.lomax@hsbcib.com

Wietse Nijenhuis
+44 20 7992 3680 wietse.nijenhuis@hsbcib.com

Asia

Garry Evans
+852 2996 6916 garryevans@hsbc.com.hk

Steven Sun
+852 2822 4298 stevensun@hsbc.com.hk

Jacqueline Tse
+852 2996 6602 jacquelinetse@hsbc.com.hk

Vivek Misra
+91 80 3001 3699 vivekmisra@hsbc.co.in