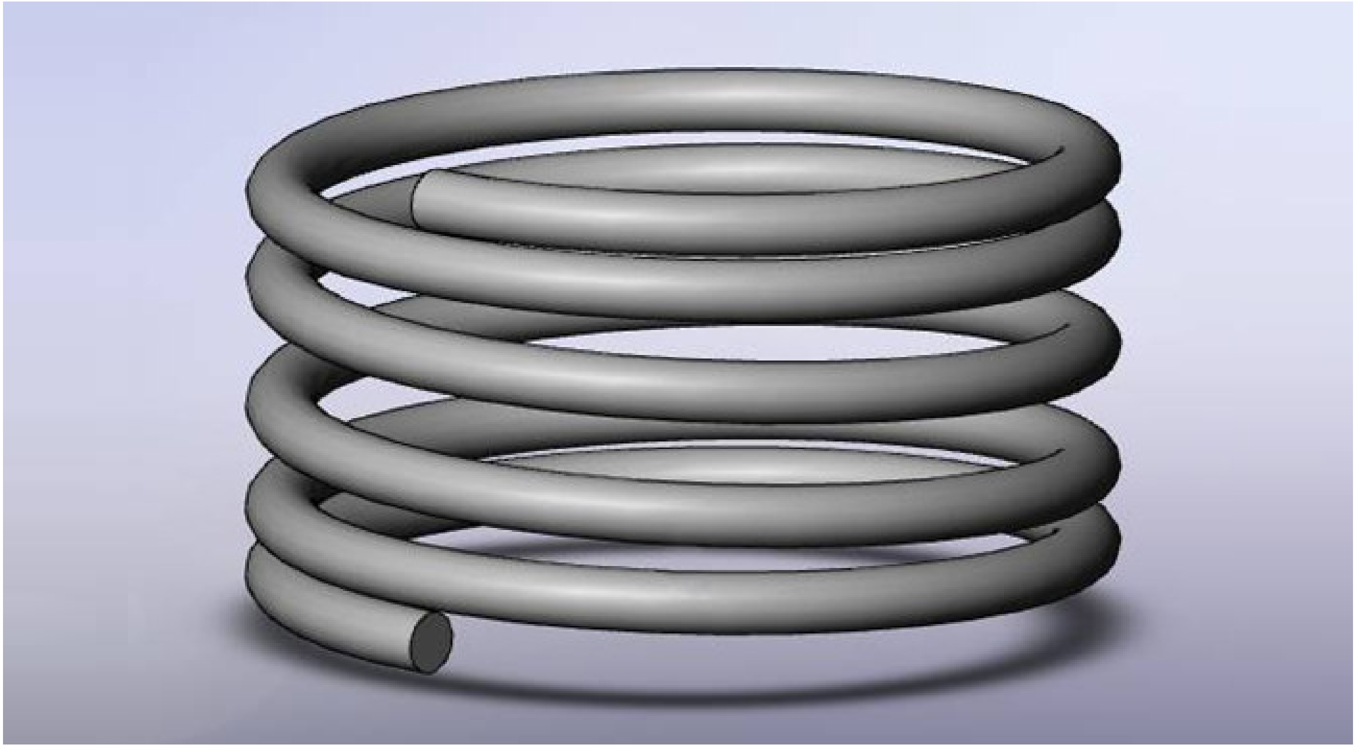
CCB International 建银国际

Hong Kong/China Equity Research

2012 2Q Market Outlook

12 April 2012



A tightly coiled spring

Hong Kong's tightly coiled equity market, now undergoing a spate of consolidation, is about to spring into a sustained rally following the market re-rating in 1Q12. We advise investors to take advantage of any market rebound (triggered by the likely cut in the reserve requirement ratio in April 2012) to rotate out of stocks exhibiting weak earnings momentum and into those in sectors offering good prospects for improving ROE. Mid-to-late 2Q12 will be a good time to accumulate stocks, just ahead of the rally in 2H12.

Taking into account earnings cyclicality, the likelihood of new government stimulative polices and financial reforms in 2Q12, we recommend an OVERWEIGHT position in consumer staples, consumer discretionary, insurance, technology and capital goods in the coming quarter.

Analyst

Dr. Peter So
(852) 2532 6786
peterso@ccbintl.com

Dr. Banny Lam
(852) 2532 2578
bannylam@ccbintl.com

Stephanie Tong
(852) 2844 3602
stephanietong@ccbintl.com

Rocky Zhang
(852) 2533 2411
rockyzhang@ccbintl.com

Table of Contents

Investment Strategy

2Q12 Market Outlook

Dr. Peter So
(852) 2532 6786
peterso@ccbintl.com

Dr. Banny Lam
(852) 2532 2578
bannylam@ccbintl.com

Rocky Zhang
(852) 2533 2411
rockyzhang@ccbintl.com

Stephanie Tong
(852) 2844 3602
stephanietong@ccbintl.com

A tightly coiled spring

- The first stage of the re-rating now taking place in Hong Kong's equity market was driven by reduced risk premiums on the back of greater market liquidity and easing concern over the European debt crisis. This initial stage came to an end in 1Q12. In early 2Q12 we are likely to see some consolidation take place in the market, providing good opportunities for investors to reposition their portfolios for a sustained rally in 2H12. In 2Q12, we see good value in China's manufacturing sector, which will benefit from lower unit production costs, restocking of currently low inventories and recovering GDP growth.

- Many investors are now wary of investing in the Chinese market following a fallow period in 1Q12 marked by weak exports, lackluster retail sales and low FAI. In an effort to arrest these declines, the National People's Congress (NPC) announced in March this year that it would take a more aggressive approach to boosting economic growth in 2012, a tacit admission that it now views China's lack of growth drivers as a more imminent threat to stability than inflation. A poor economic performance in 1Q12 will elicit more policy loosening to offset declining external demand. In this environment, we believe fiscal stimulus and monetary easing are imminent and we expect economic growth momentum to pick up in 2Q12.

- China's inflation rate is easing towards 3-4%, leaving the government room to instigate monetary easing. As we move further into 2Q12, expect lending to be extended to corporate enterprises, especially SMEs. We expect the PBOC to accelerate the pace of credit loosening, with a 50bp RRR cut in 2Q12 designed to encourage FAI and consumption.

- This report identifies **three themes that could drive a stock re-rating: (1) government stimulative policies; (2) a recovery in earnings momentum in 1H12; and (3) financial reform in China.** In our view, **mid-to-late 2Q12 is an opportune time to accumulate quality stocks as it comes just ahead of interim earnings releases in 3Q12.**

- **We suggest investors take overweight positions in consumer discretionary, consumer staples, insurance, technology and capital goods**, as we believe these sectors will outperform the market in 2Q12 on the back of earnings improvement brought about by lower production costs and sustained end-user demand growth.

- We **downgrade the materials and banking sectors to Neutral** as we project firms in these industries will experience slower earnings momentum in 2012. Meanwhile, we **upgrade shipping and airlines to Neutral** in anticipation of recovering demand, possible policy support and limited downside risk.

- **Top picks.** AAC Technologies (2018 HK, Outperform), Belle (1880 HK, Outperform), China COSCO (1919 HK, Outperform), CITIC Securities (6030 HK, Outperform), CNBM (3323 HK, Outperform), CPIC (2601 HK, Outperform), CR Land (1109 HK, Outperform), ICBC (1398 HK, Outperform), Singamas Container (716 HK, Outperform), Sinopharm (1099 HK, Outperform) and Vinda (3331 HK, Outperform).

CCBIS sector weightings

Consumer discretionary	Overweight
Consumer staples	Overweight
IT and technology	Overweight
Capital goods	Overweight (upgrade from Neutral)
Insurance and financial services	Overweight
Materials	Neutral (downgrade from Overweight)
China banks	Neutral (downgrade from Overweight)
Hong Kong banks	Neutral
Energy	Neutral
Autos	Neutral
China property	Neutral
Hong Kong property	Neutral
Shipping	Neutral (upgrade from Underweight)
Airlines	Neutral (upgrade from Underweight)
Telecom services	Underweight
Utilities	Underweight

Source: CCBIS

Valuation for top picks in 2Q12

Company	Stock code	Rating*	Price (HK$)#	Target price (HK$)	EPS growth (%) 2012F	EPS growth (%) 2013F	P/E (x) 2012F	P/E (x) 2013F	Dividend yield (%) 2012F	Net margin (%) 2012F	Net margin (%) 2013F	ROE (%) 2012F
AAC Technologies	2018 HK	O	23.95	27.20	34.9	27.3	17.0	13.4	2.6	26.4	26.7	24.2
Belle	1880 HK	O	13.94	15.20	11	18	20.3	17.2	1.5	13.8	14.1	22.3
China COSCO	1919 HK	O	4.95	6.70	68.6	10.1	66.9	10.9	0.0	1.0	4.0	1.0
CITIC Securities	6030 HK	O	16.08	17.50	(49)	35.4	16.9	12.4	3.5	–	–	7.8
CNBM	3323 HK	O	10.70	14.80	4.7	7.7	5.6	5.2	2.4	9.3	9.2	19.9
CPIC	2601 HK	O	24.15	29.00	45.0	24.0	11.4	9.2	2.4	–	–	14.7
CR Land	1109 HK	O	14.22	16.14	27.2	25.4	9.9	8.0	2.6	17.5	17.4	10.9
ICBC	1398 HK	O	5.05	6.35	13.1	12.8	6.1	5.4	5.9	–	–	22.7
Singamas Container	716 HK	O	2.19	3.20	12.6	24.1	9.4	4.0	2.5	16.1	15.7	9.8
Sinopharm	1099 HK	O	20.85	25.75	24	28	20.6	16.1	1.4	1.6	1.6	8.9
Vinda	3331 HK	O	12.28	13.10	68	29	13.7	10.6	1.8	11.2	11.5	20

** CCBIS ratings: O = Outperform*

 # Data as of 12 April 2012

Source: Bloomberg, CCBIS

Transitioning to the next stage

Value drivers: risk premiums and ROE

The sharp rebound in the stock market triggered by falling risk premiums that began in late 4Q11 has ended, in our view. As described in our *2012 Market Outlook* (*2012 Market Outlook: Revitalizing the dragon,* 7 December 2011), anxiety over a liquidity crunch, high interest rates and credit risk resulted in high risk premiums for equity investments. Risk premiums crested in 4Q11 after China took action with RRR cuts and Greece began to take measures to address its debt problems.

Our *2012 Market Outlook* demonstrates that the equity value of a company is represented by the simplified Gordon model described below:

Value (V) = sum of all future dividends/(1 + discount rate, r)^n

Assuming constant growth, **g,** for a company

V = dividend of current year * (1 + g)/(r – g)

At constant corporate earnings growth, g equals return on equity (ROE).

The equity value for a corporation depends on two parameters: **(1) risk premium and (2) ROE.**

First stage of a re-rating: a reduction in risk premium

The first stage of the current re-rating has ended

Stocks sensitive to risk categories prevalent in the market in 2011 are highlighted in the table below. In the last few months, various risk indicators suggest that some of the risks that were prominent in 2011 are now abating, leading to significant rebounds in the share prices of stocks that were subject to those risks. The latest data trackers, including the VIX, indicate that perceived risk has improved to pre-2011 levels, a sign that the first stage of the current market re-rating has ended. Stocks across-the-board benefited from this first phase of the re-rating, which drove the Hang Seng Index above 21,500 or 10.9x 2012F P/E.

First stage of re-rating in 1Q12: risk premium reduction

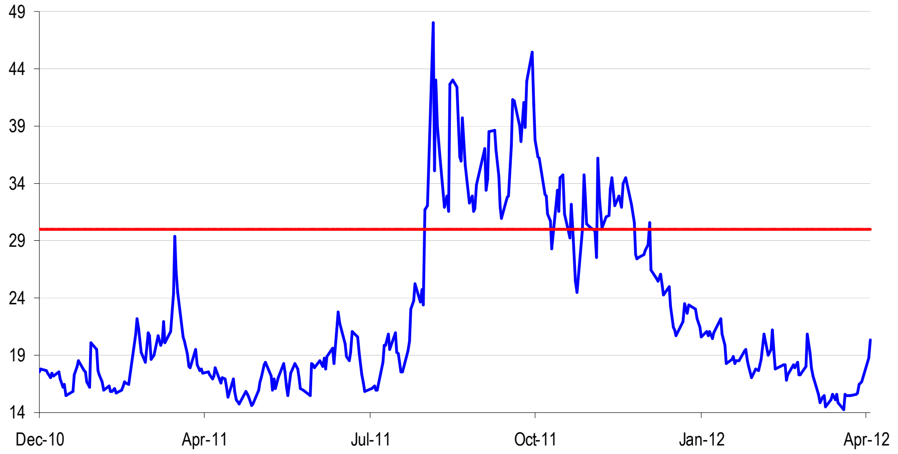
	Type of risk	Trend in 1Q12	Data tracker	Most sensitive sectors	Companies most sensitive to trend
Environment in China	Liquidity	Improved	New loans M1/M2 growth	Leveraged stocks (e.g. property, banks, capital goods, materials)	COLI (688 HK, Neutral) ABC (1288 HK, Outperform) CNBM (3323 HK, Outperform) CR land (1109 HK, Outperform)
Environment in China	Credit	Improved	Loan defaults NPL ratio China Credit Monitor	SMEs China banks Non-SOE geared companies	Minsheng Bank (1988 HK, Outperform) ABC (1288 HK, Outperform) Country Garden (2007 HK, Outperform)
Environment in China	Market	Improved	Index movement Economic data	Financial services High beta companies Insurance	CITIC Securities (6030 HK, Outperform) HKEx (388 HK, Neutral) Ping An Insurance (2318 HK, Outperform) Zijin Mining (2899 HK, Outperform)
Environment in China	Policy	Improved	Monetary measures Fiscal measures	Strategic industries Agriculture Consumption	CMR (773 HK, Outperform) Golden Eagle (3308 HK, Not Rated)
Environment in China	Interest rate	Down	Effective lending rate Bond yields	China banks Property Capital goods Materials, SME	ABC (1288 HK, Outperform) CNBM (3323 HK, Outperform) Country Garden (2007 HK, Outperform)
International environment	International debt (e.g. Europe/US)	Uncertain	CDS/CDO Bond yields Credit ratings	International operators Exporters Foreign asset holders	HSBC (5 HK, Neutral) Espirit (330 HK, Not Rated) Yanzhou Coal (1171 HK, Outperform)
International environment	Economics and exports	Deteriorated	BDI Container throughput	Exporters Ports/shipping companies International airlines	CNOOC (883 HK, Not Rated) Yanzhou Coal (1171 HK, Outperform) Tianjin Port (3382 HK, Not Rated) OOIL (316 HK, Underperform) Cathay Pacific (293 HK, Underperform)
International environment	Liquidity flows	Weak	Exchange rate Trade surplus	Financial services International operators	HSBC (5 HK, Neutral) AIA (1299 HK, Neutral) Standard Chartered (2888 HK, Outperform)

Source: CCBIS

Indicators showing significantly lower perceived risk

Perceived risk returning to pre-crisis levels

VIX back to pre-2011 levels



Source: Bloomberg, CCBIS

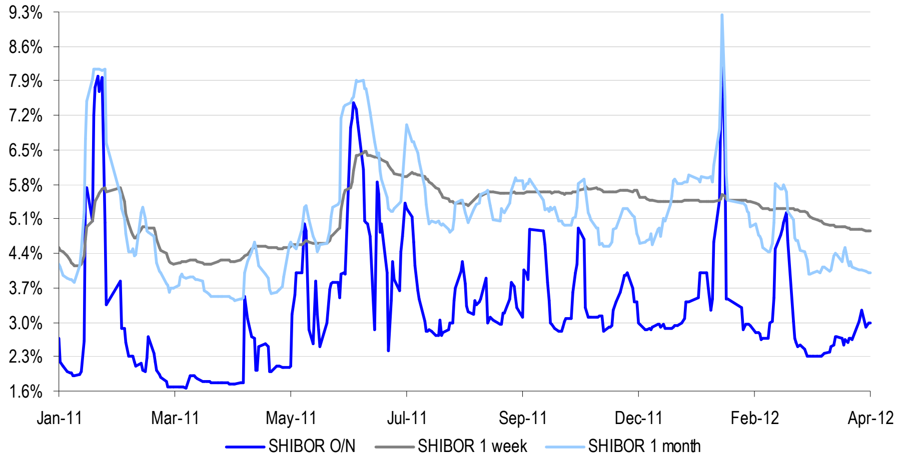
Italian five-year CDS significantly below peak levels

Source: Bloomberg, CCBIS

French five-year CDS almost back to pre-August 2011 levels

Source: Bloomberg, CCBIS

SHIBOR indicates lower market concern over a liquidity crunch



Source: Bloomberg, CCBIS

Second stage of a re-rating: ROE enhancement

What is the next area of focus?

In the second phase of a stock re-rating, investors are likely to put more emphasis on the long-term prospects of corporations by focusing on earnings growth and improving ROE. In China, this stage began in late 1Q12. It is in this second stage of a re-rating that stock picking becomes critical. This stage also tends to last much longer than the first. The re-rating potential of a given stock will depend on government policy, the earnings cyclicality of a given corporation, and the potential for business growth. In the table below we synthesize the attributes contributing to ROE enhancement and the government policies most likely to be implemented in 2012. How each of these policies would likely affect each attribute/driver of ROE is also addressed. Policies or aspects of the business environment capable of expanding profit margins, asset turnover or else encouraging companies to gear up to expand ROE will benefit some companies more than others.

Second stage of re-rating from late 1Q12 : enhancement of ROE, economic trends and possible policies

Return on equity (ROE)

	Profit margin	Asset turnover	Gearing
Key drivers	Profit margin	Asset turnover	Gearing
Possible trends and influential factors in 2012	1. Falling PPI and production costs	1. Robust consumption underpinned by policy support	1. De-leverage for property in early 2012
	2. Rise in minimum wage and civil servant salaries increasing labor costs	2. Sustained FAI growth, e.g. social housing schemes	2. As credit eases, re-leverage in mid-to-late 2012 for corporations
	3. Tax allowance for select industries	3. Restocking demand for consumer/capital goods	3. Cut in RRR to raise liquidity and help expand borrowing
	4. Lower import tariffs for imported materials	4. Destocking for property developers	4. Relaxed lending policies, especially for SMEs, to drive new loan growth
	5. Falling export prices	5. Government subsidies, higher tax threshold and incentive policies	5. Increased M&A, especially in overseas markets
	6. Declining effective interest rates	6. Supportive fiscal policies for strategic industries	6. Opening up of restricted industries to non-SOE to help investment growth

Source: CCBIS

Suggested trading tactics for 2Q12

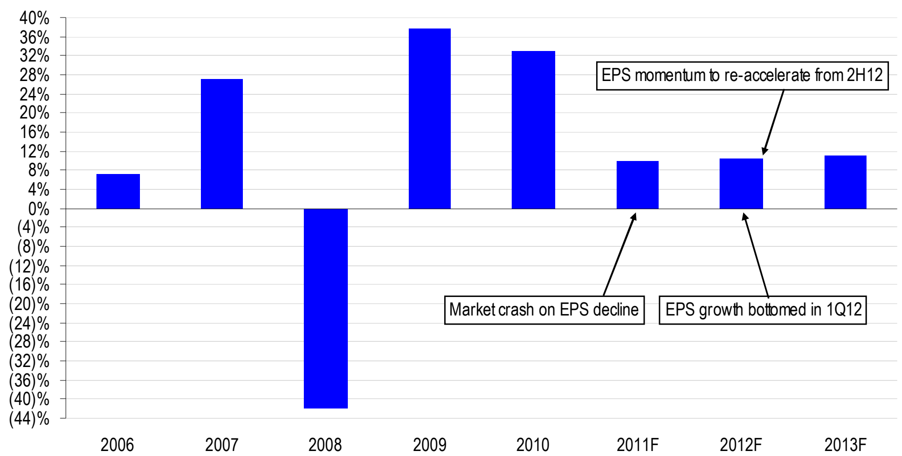
Stocks that rebounded the most in 1Q12 were those with high beta that had been hit by increasing concerns on credit risk or even fears of a crash in earnings. Not all of these stocks will be able to sustain strong earnings growth in the remainder of 2012, and some may underperform the market in the coming months. Our advice is to **lock in profit in 2Q12 for those stocks with declining earnings/ROE momentum from 1Q12.** Examples include **the banking stocks, materials and telecom service operators**.

The annual EPS growth trend for the HSI indicates a trough of 9.9% in 2011 forecast to accelerate to 10.3% in 2012 and 11.0% in 2013 assuming RRR cuts are announced and implemented. We believe the Chinese government may announce more policies to stimulate consumption in the coming months, which may lead to **earnings upgrades in 2012 and 2013.**

Possible inflection point in the latter part of 2Q12

The market was disappointed by 2H11 results and unloaded certain stocks, among them Gome (493 HK, Underperform). In the early part of 2Q12, investors are likely to remain chastened by falling earnings growth momentum – a carry-over from 4Q11. **This double-edged sword of improving profits accompanied by heightened investor anxiety is often the precursor to a turning point ahead of a market rally.** We recommend investors take advantage of current market consolidation and accumulate stocks with recovering ROE as well as those that stand to benefit from government stimulative policies. Sell names exhibiting weakening earnings growth.

HSI's EPS YoY annual growth



Source: Bloomberg, CCBIS

Outperforming with sector rotation

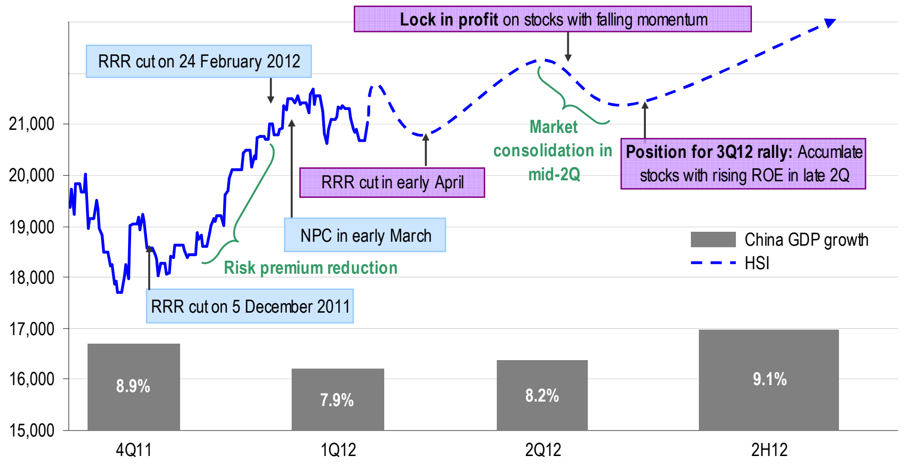
The cumulative effect of RRR cuts, the increase in liquidity and supportive government policy arising from the NPC is likely to boost China's economy and give rise to a recovery in corporate earnings in 2H12. In 2Q12, we expect greater volatility as investors unload stocks with weaker earnings prospects and rotate to oversold stocks. CCBIS' chief economist, Dr. Banny Lam, forecasts an RRR cut in April 2012, which may trigger a rally in the stock market. **We advise investors lock in profits for sectors with slowing earnings momentum during the rally, in particular on Chinese banking and telecom stocks.**

In the latter part of 2Q12, investors would be well advised to accumulate stocks ahead of the interim results announcements, which we expect to herald an economic recovery in China. A smooth transition in leadership at the top echelons of the Communist Party of China and the subsequent implementation of the major economic plans outlined in the NPC will give rise to positive market sentiment in 2H12. Investors should move ahead of these positive changes by taking action in late 2Q12.

Maximizing profit with the right strategy

Our channel checks seem to confirm that investment activity on the whole has been sluggish ahead of the government's leadership changes in 4Q12. Investment activity should return to normal levels once these leadership changes have been made official. **We expect the stock market to factor in a reacceleration in economic activity and then regain momentum in the latter part of 3Q12. Investors stand to make outsized returns by accumulating quality stocks in late 2Q12, just ahead of the market rally.**

Trading strategy in 2012



Source: Bloomberg, CCBIS

Investment themes in 2Q12

As mentioned above, the key driver of stock market performance in 1H12 will be ROE enhancement. Buying interest will focus on stocks with ROE momentum, which will ultimately be a function of liquidity, business cycles and new government policies. In our opinion, key investment themes in 2Q12 will include the following.

1. China's yet-to-be-launched policies to stimulate domestic consumption and investment;

2. The recovery in corporate earnings;

3. Financial reform, including the internationalization of the renminbi.

Theme 1: China policies to stimulate domestic consumption and economic activity

Impact of stimulative policies not fully accounted for

China has reiterated that uncertainty in the international environment (and thus prospects for export growth) has persisted into 2012, and that more effort will be needed to boost domestic consumption, mainly through more supportive policies. As only a few policy initiatives were mentioned during the NPC, we expect more concrete measures to be introduced from 2Q12 onwards to support China's economic recovery.

We highlight possible China policies that may drive different attributes of ROE leading to forecast earnings changes. We also highlight those sectors that stand to benefit most from these policies.

Expected China policies and their likely impact on sectors and stock picks

Anticipated government policy	Effect	Sector impact	Likely beneficiaries
1. RRR cuts	Expand margins, reduce effective interest rates and raise liquidity	Positive to banks, highly geared companies, developers or capital goods manufacturers. Accelerate a stock market recovery	BoCom (3328 HK, Neutral) CR Land (1109 HK, Outperform) Shanghai Electric (2727 HK, Not Rated) CITIC Securities (6030 HK, Outperform)
2. Reduction in import tariffs	Expand margins and reduce cost of operations or end-user prices	Stimulate purchases of consumer goods or reduce production costs of manufacturers. Raise demand for shipping and port services	Golden Eagle (3308 HK, Not Rated) Intime (1833 HK, Not Rated) China COSCO (1919 HK, Outperform)
3. Expansion of current experimental tax reform in Shanghai to convert business tax to VAT	Reduce tax expenses of most services industries and reduce logistics costs of most manufacturers and retailers	Positive to the service industry, transportation, and the cargo handling industry	Logistics and transportation companies
4. More cuts in personal income tax and corporate tax on SMEs	Expand margins and increase purchasing power of individuals	Positive to retailers and producers of consumer goods	Belle (1880 HK, Outperform) Skyworth (751 HK, Not Rated) Golden Eagle (3308 HK, Not Rated)
5. Subsidies to purchase consumer goods for low-income individuals	Increase sales and production of consumer goods	Positive to the consumer sector, furniture producers, retailers and supermarkets.	Springland (1700 HK, Outperform) Golden Eagle (3308 HK, Not Rated)
6. Government investments in new strategic industries and the agriculture sector	Increase FAI and investment in related sectors	Positive to new strategic industries and the agriculture sector	GCL-Poly Energy (3800 HK, Outperform) Tencent (700 HK, Not Rated) Lenovo Group (992 HK, Neutral) China BlueChem (3983 HK, Not Rated) First Tractor (38 HK, Not Rated) ABC (1288 HK, Outperform)

(continued on next page)

Expected China policies and their likely impact on sectors and stock picks (continued from previous page)

Anticipated government policy	Effect	Sector impact	Likely beneficiaries
7. Expansion of social housing scheme	Raise asset turnover of construction and consumer sectors	Increase demand for construction services and materials, as well as consumer products	China State Construction (3311 HK, Not Rated) CNBM (3323 HK, Outperform) Skyworth (751 HK, Not Rated)
8. Greater FAI or infrastructure activities	Raise asset turnover of construction activity and domestic demand for materials, while sustaining GDP growth	Increase demand for construction (e.g. underground railways) and loans	CNBM (3323 HK, Outperform) China State Construction (3311 HK, Not Rated)
9. Increase imports of raw materials, components and IT products	Raise asset turnover of distributors or logistics companies, but reduce margins of domestic producers	Positive to shipping and port operators, but negative to materials producers	China COSCO (1919 HK, Outperform) China Merchants (133 HK, Not Rated)
10. Relaxation of investment constraints for foreigners or non-SOE enterprises in China or for domestic investors investing overseas	Raise investment and asset turnover in various sectors	Greater demand for financial services, construction and capital goods. More QDII and QFII will be approved	CITIC Securities (6030 HK, Outperform) HKEx (388 HK, Neutral)

Source: CCBIS

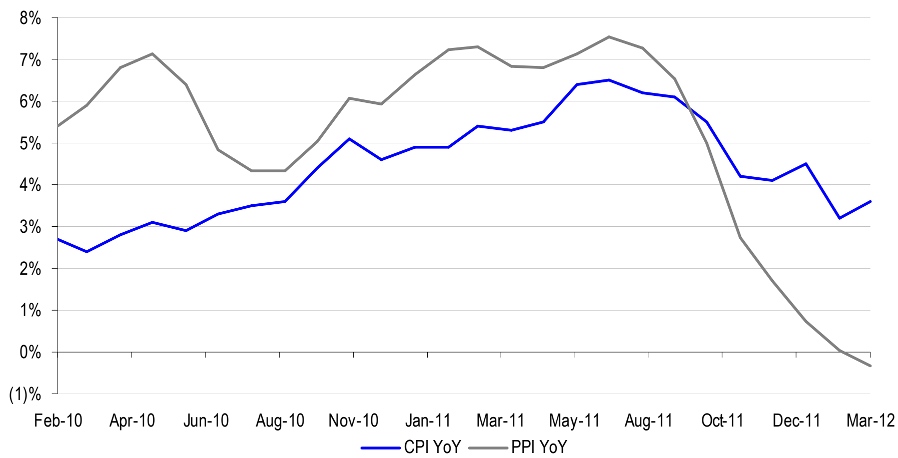
Theme 2: Recovery in earnings momentum

Government statistics indicate profits of large-scale industrial enterprises fell 5.2% YoY in January-February 2012, largely on weak economic growth in 1Q12 and the carryover effect of credit tightening in 2H11. As China is taking action to stimulate its economy by means of monetary loosening and fiscal stimulus, we look for GDP growth to reaccelerate from 2Q12 onwards, with positive implications for earnings growth.

Prefer the manufacturing sector over the financial sector

We forecast the momentum of an earnings recovery will vary from industry to industry and will depend heavily on how aggressive the government is in implementing stimulative policies. The weakening production price index (PPI) implies a possible year-on-year decline in the unit cost of production and is likely to have a **positive impact on the manufacturing sector** should demand within for the sector begin to recover.

Changes in China's CPI and PPI are positive to the manufacturing sector



Source: Bloomberg, CCBIS

Product demand in the manufacturing sector will get a boost from the following developments.

1. The introduction of policies designed to boost domestic consumption in China, including policies intended to increase demand for consumer durables;
2. Recovering exports to Southeast Asia and the US;
3. Increasing property sales as mortgage lending is relaxed and developers cut selling prices;
4. Restocking in distribution operations (including retailing and wholesaling) as credit is eased and the business cycle recovers.

Re-stocking in progress

The following factors have a significant impact on ROE and the potential for a re-rating of corporations.

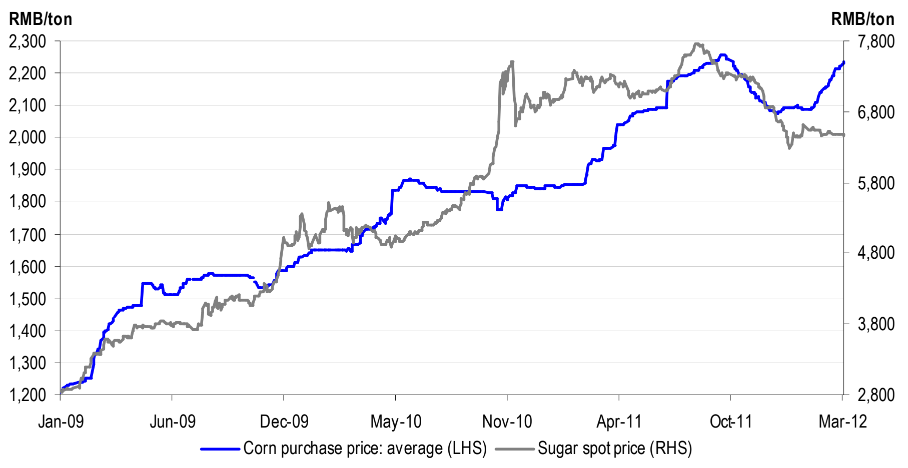
1. Product and raw material price movements;
2. Restocking;
3. 1Q12 or 1H12 YoY earnings growth.

Movements of product and raw material prices

These price movements will affect **the margins of manufacturers**, and the changes have already been noticeable in materials or intermediary industries, such as paper and packaging. Other examples include the following.

1. **The sweetener industry** which has been negatively affected as the price of the main raw material, corn, has been on the rise while sweeteners have suffered from increasing supply and declining prices. **Global Sweeteners (3889 HK, Not Rated) and Xiwang Sugar (2088 HK, Not Rated) will suffer from this divergent price cycle.** They may see a cyclical de-rating as their margins and ROE are likely to continue to shrink in the current business cycle.

Corn and sugar prices exhibit divergent trends

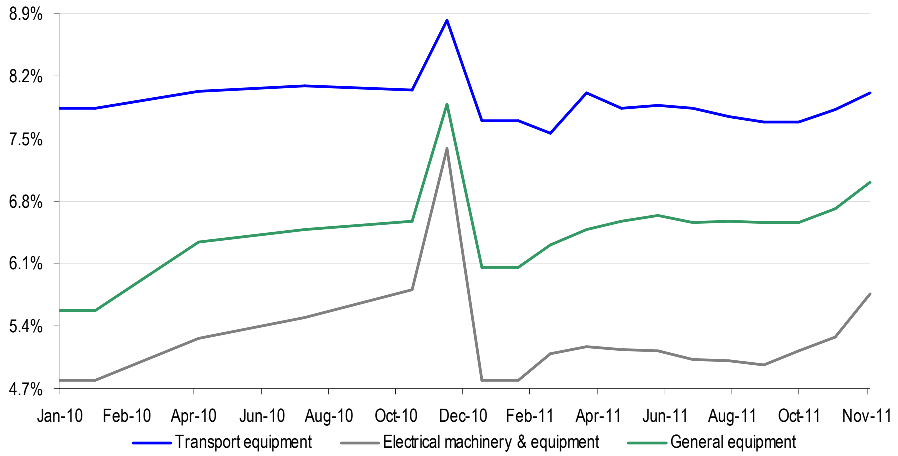


Source: CEIC, CCBIS

2. **Manufacturers of staple products or select capital goods** (e.g. machinery equipment with defined contract prices) will benefit from declining prices of input raw materials such as steel. **Singamas Container (716 HK, Outperform), Shanghai Electric (2727 HK, Not Rated) and Harbin Electric (1133 HK, Not Rated) are likely beneficiaries.**

Margin trends will vary widely

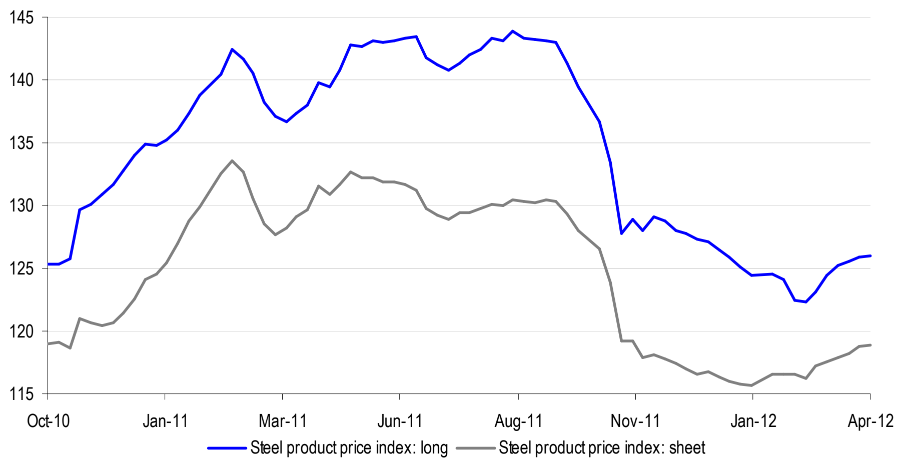
Profit margin of equipment manufacturers has expanded since 4Q11 after a fall in the price of raw materials



Source: CEIC, CCBIS

Steel saw margin pressure in 1Q12

Steel product prices have been declining from the peak in 2011



Source: CEIC, CCBIS

3. **Margin contraction expected for Chinese banks in 2H12**

Most Chinese banks were able to expand their net interest margin (NIM) aggressively in 2H11, despite credit tightening. With the successive cuts in RRR since December 2011, effective interest rates have been reduced, especially for medium to small-sized enterprises. Chinese banks are likely to maintain their 1Q12 or 1H12 NIM levels but may see a NIM decline in 2H12 YoY. **We advise investors to move out of the Chinese banking sector in late 2Q12 and look for opportunities in the recovering manufacturing industry, especially capital goods, China property and shipping.**

China banks net interest margin expected to shrink in 2H12

Company	Stock code	1Q10 (%)	2Q10 (%)	3Q10 (%)	4Q10 (%)	1Q11 (%)	2Q11 (%)	3Q11 (%)	4Q11 (%)	1H12F (%)	2H12F (%)
ICBC	1398 HK	2.33	2.40	2.43	2.53	2.58	2.61	2.61	2.64	2.64	2.57
BOC	3988 HK	2.04	2.04	2.04	2.13	2.11	2.11	2.09	2.16	2.14	2.08
BoCom	3328 HK	2.41	2.46	2.45	2.50	2.51	2.56	2.61	2.68	2.65	2.55
CMB	3968 HK	2.49	2.63	2.63	2.89	2.98	3.00	3.12	3.15	3.10	3.00
ABC	1288 HK	2.42	2.52	2.59	2.73	2.79	2.79	2.83	2.96	2.87	2.73
Minsheng	1988 HK	2.92	2.91	2.94	2.94	2.85	3.15	3.21	3.35	3.20	3.06
CITIC	998 HK	2.44	2.55	2.58	2.67	2.82	2.96	3.09	3.13	3.01	2.85
CRCB	3618 HK	N/A	N/A	N/A	N/A	3.18	3.27	3.45	3.53	3.40	3.12

Source: CCBIS

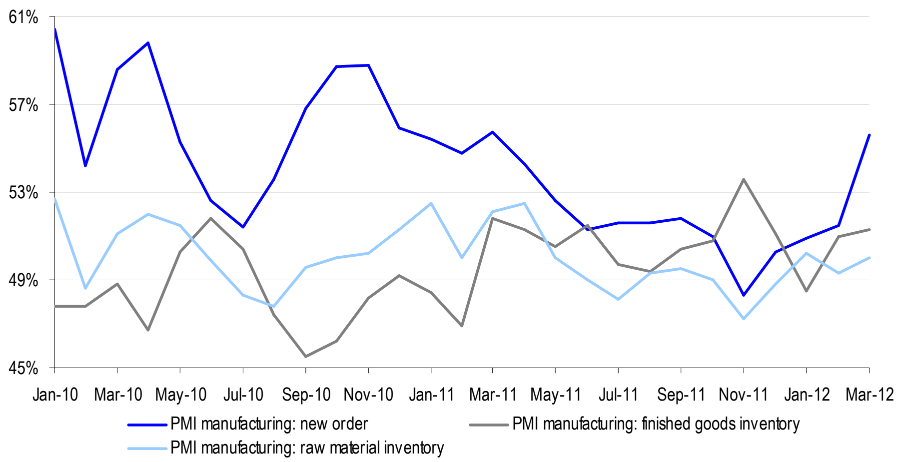
Restocking potential of manufacturers/distributors

China's credit tightening raised the financial costs of many enterprises in 2011, forcing them to carry sub-normal inventory levels. As consumption and production activities gradually recover, these enterprises need to increase their stock levels to avoid interruptions to their manufacturing or distribution operations.

Which sectors are under-stocked?

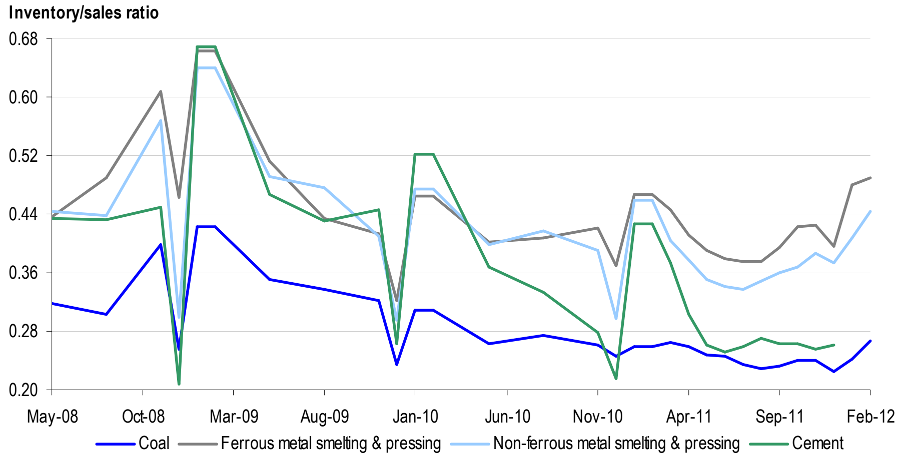
The charts on the next page show that the inventory-to-sales ratios of the ferrous and non-ferrous smelting industries are high while those of the coal and cement industries fell to low levels. Inventories of the electrical machinery, transport equipment and construction machinery industries have fallen from their peak in 2011. Should credit ease further, we believe the restocking process will trigger more order flows. Indeed, **China's PMI new orders already reflect improvement in some of these industries**. CNBM (3323 HK, Outperform), China Coal (1898 HK, Outperform), Shanghai Electric (2727 HK, Not Rated), Dongfang Electric (1072 HK, Not Rated) and Avichina (2357 HK, Not Rated) will benefit should restocking take place in the cement, coal, machinery and transport equipment component sectors.

PMI new orders have been improving with re-stocking trend in sight



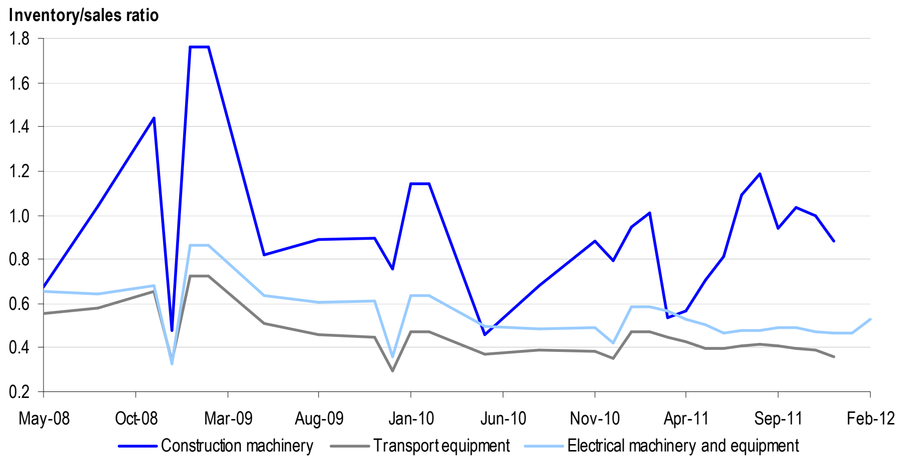
Source: CEIC, CCBIS

Inventory-to-sales ratios of materials sectors



Source: CEIC, CCBIS

Inventory-to-sales ratios of machinery & equipment sectors



Source: CEIC, CCBIS

Year-on-year change in earnings momentum in 1Q12 and 1H12

What will disappoint investors?

Enough corporations exhibiting improving year-on-year growth will serve to improve investor sentiment. Investors would be attracted to companies that were capable of sustaining high year-on-year growth in 1Q12 or 1H12. We believe companies whose earnings bases were higher in 1H11 but whose margins and earnings began to slide rapidly in 2H11 may be at **risk of disappointing investors by reporting poor year-on-year earnings in 1H12**. The following industries are expected to see a noticeable change in year-on-year earnings momentum.

Earnings slowdown in the cement and steel sectors

1. **China's cement and steel industries will exhibit weaker year-on-year earnings growth in 1H12.** Although the cement sector performed impressively in 2011, achieving high earnings growth to justify its P/E rating, the sector is likely to enter a period of slow growth starting in 2012 after strong earnings performance over the past three years. Steel manufacturers with high inventories and weak product prices may find 2012 a particularly challenging year. Within the cement sector, CNBM is our top pick and we expect it to record 12% YoY growth in 2012 profit.

2. **Pharmaceutical may see re-rating,** with declining raw material prices and recovering margin. They are likely to experience high YoY earnings growth in 1H12.

Earnings growth momentum of upstream, mid-stream and downstream industries in China

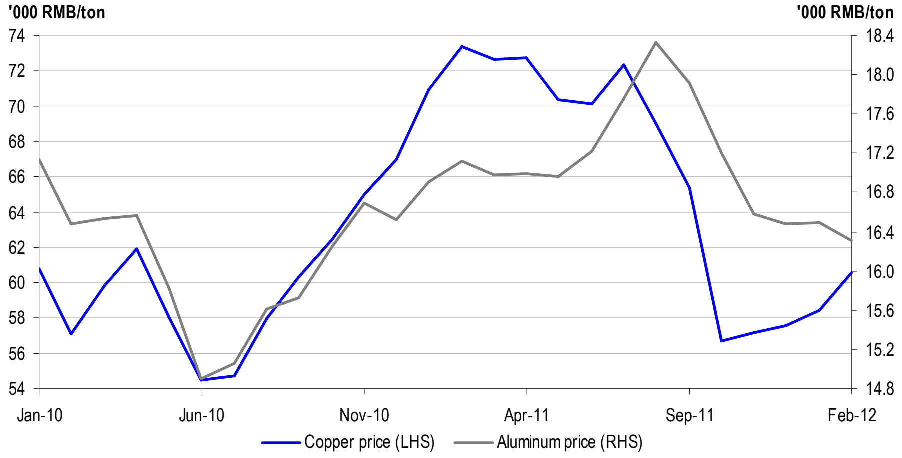
Profit growth (YoY)	1H09	2H09	1H10	2H10	1H11	2H11
Steel sector						
Sector profit (RMB m)	1,725	53,663	50,718	37,420	56,374	31,156
Industry HoH change (%)	N/A	3,011	(5)	(26)	51	(45)
Industry YoY change (%)	(98)	N/A	2,841	(30)	11	(17)
Pharmaceutical sector						
Sector profit (RMB m)	38,265	61,131	71,058	62,051	65,668	83,762
Industry HoH change (%)	(18)	60	16	(13)	6	28
Industry YoY change (%)	17	31	86	2	(8)	35
Coal sector						
Sector profit (RMB m)	86,156	134,675	151,366	193,286	201,256	232,917
Industry HoH change (%)	(41)	56	12	28	4	16
Industry YoY change (%)	(4)	(7)	76	44	33	21
Cement sector						
Sector profit (RMB m)	14,869	34,869	18,681	55,310	46,920	58,281
Industry HoH change (%)	(40)	135	(46)	196	(15)	24
Industry YoY change (%)	23	40	26	59	151	5
Transportation equipment sector						
Sector Profit (RMB m)	101,868	204,465	202,396	283,244	235,222	274,631
Industry HoH change (%)	(10)	101	(1)	40	(17)	17
Industry YoY change (%)	3	80	99	39	16	(3)

Source: CEIC, CCBIS

Materials stocks to weaken after a rebound in early 1Q12

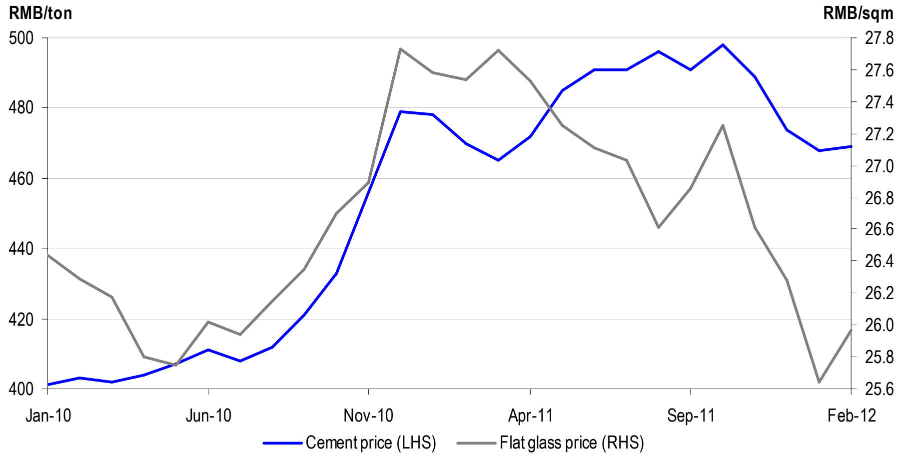
Recent price weakness in many materials stocks, post restocking, suggests year-on-year earnings growth enjoyed in 1Q12 or even 1H12 will slow rapidly. Many ferrous and non-ferrous miners are likely to exhibit similar price weakness in 1H12. In contrast, oil stocks within the energy sector exhibited considerable price resilience in 1Q12. We anticipate the materials sector to perform poorly in 1H12, although some stocks within the sector may outperform as they reap the benefits of government supportive policies.

Copper and aluminum prices saw YoY weakness in recent months



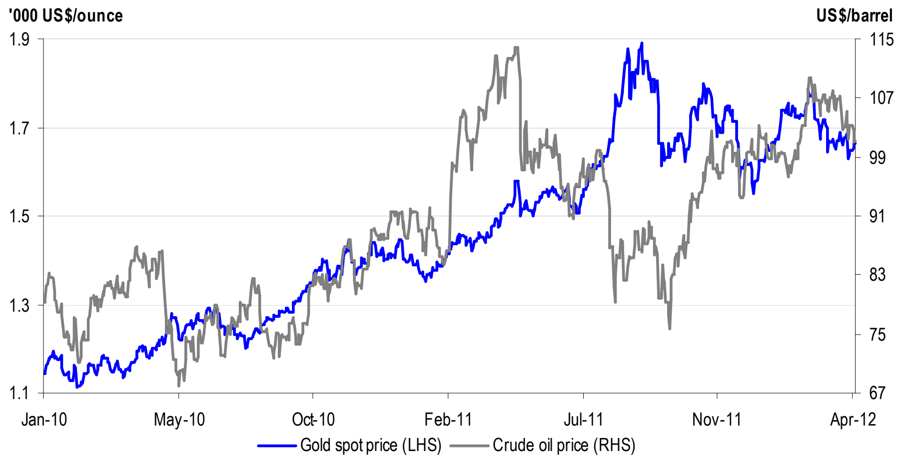
Source: CEIC, CCBIS

Cement and glass price movements hint at slower YoY earnings growth in 1H12



Source: CEIC, CCBIS

Oil and gold prices have been relatively resilient



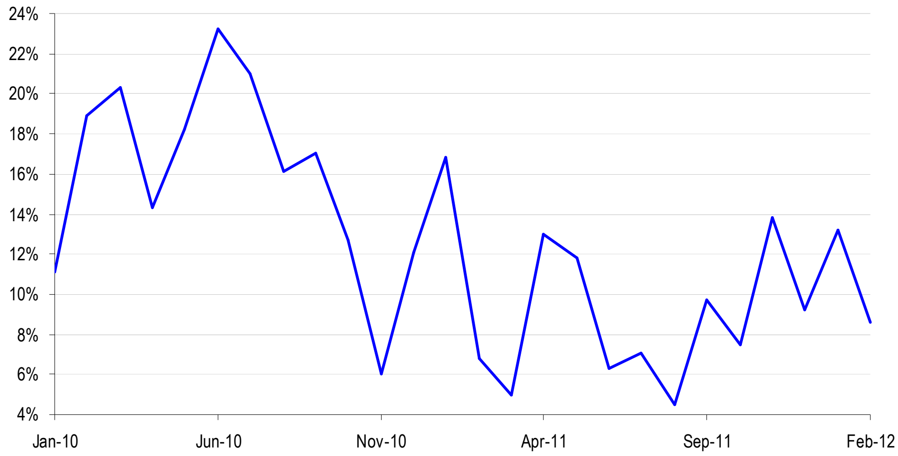
Source: CEIC, CCBIS

Valuations of airlines at distressed levels

Position ahead of holiday season

Chinese airlines were under heavy selling pressure in the past quarter due to high oil prices and operating costs. Nevertheless, in terms of valuation (e.g. price-to-book), their prices returned to levels close to their lows in 2011, which we believe is unjustified. Sustained growth in passenger numbers within the civil aviation sector, and planned stimulus from the Chinese government aimed at boosting domestic consumption and entertainment should provide support to sector earnings. Airlines may also benefit from rising passenger numbers ahead of the Labor Day holiday in 2Q12. China Southern Airlines (1055 HK, Outperform) is our top stock pick within the sector.

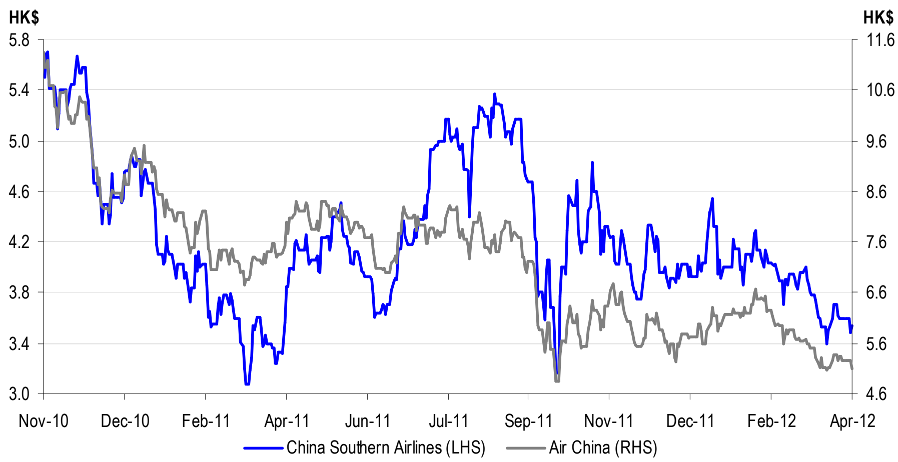
Passenger growth within the civil aviation segment showed seasonal strength towards mid-year



Source: CEIC, CCBIS

Valuations of airlines close to the bottom

Price movements of China Southern Airlines and Air China



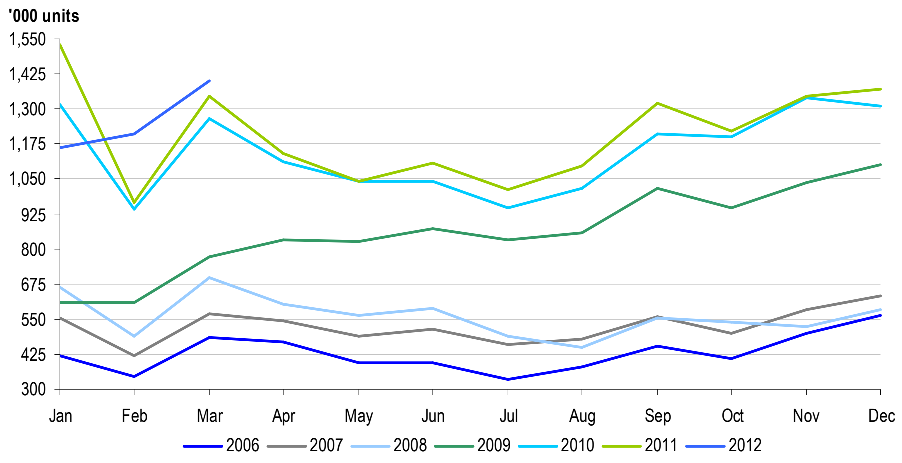
Source: Bloomberg, CCBIS

Auto sector to see a seasonal downswing

Auto: buy on fundamentals, though technical weakness may be just around the corner

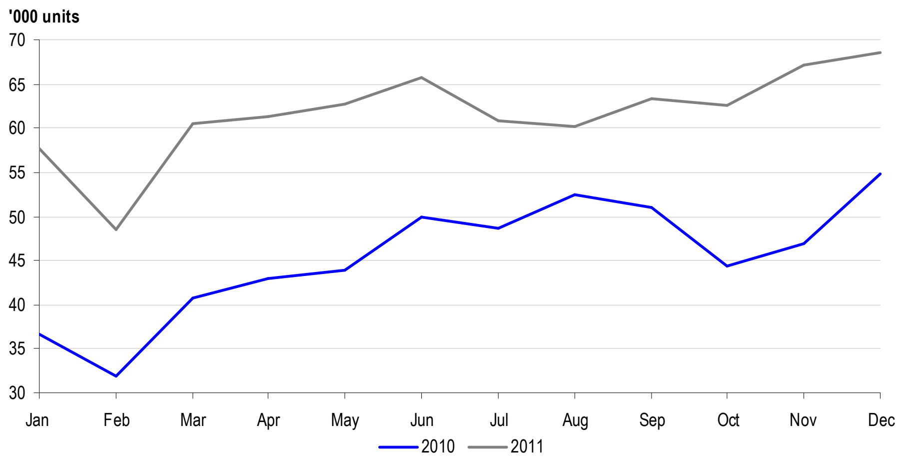
The performance of most auto makers was strong in 1Q12, partly due to lower material prices that improved auto maker margins and the expectation of robust growth in domestic consumption. We are concerned that seasonal weakness in the passenger car market, normally taking price in 2Q-3Q, may be used as an excuse for profit taking in 2Q12. Nevertheless, the luxury car segment is likely to be more resilient than the medium to low-end car segment in terms of car sales. We recommend investors accumulate Brilliance China (1114 HK, Outperform), as the company stands to benefit from the introduction of its new passenger car models in the coming weeks.

China passenger vehicle market shows seasonal weakness in 2Q-3Q



Source: CAAM, CCBIS research

Premium brands exhibit less seasonality



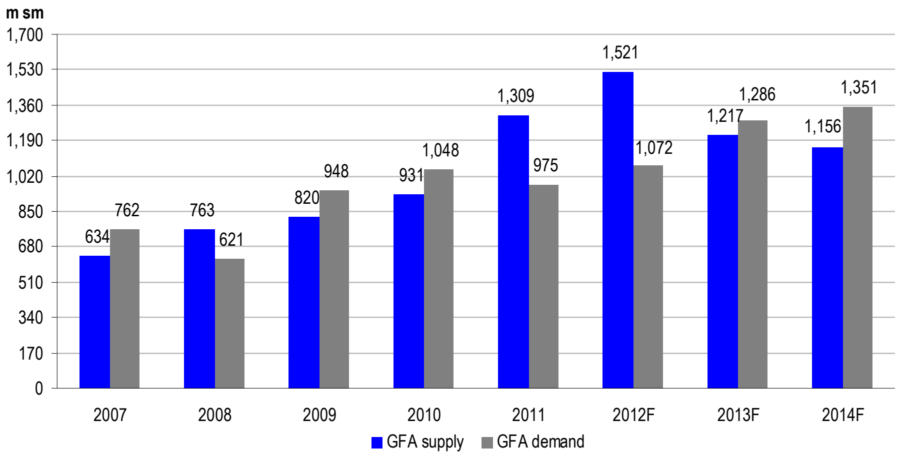
Note: The lines show total sales volume of Benz, BMW and Audi in China
Source: CAAM, CCBIS research

China property to see a turnaround in 2H12

More price cuts in China's property sector in 2Q12

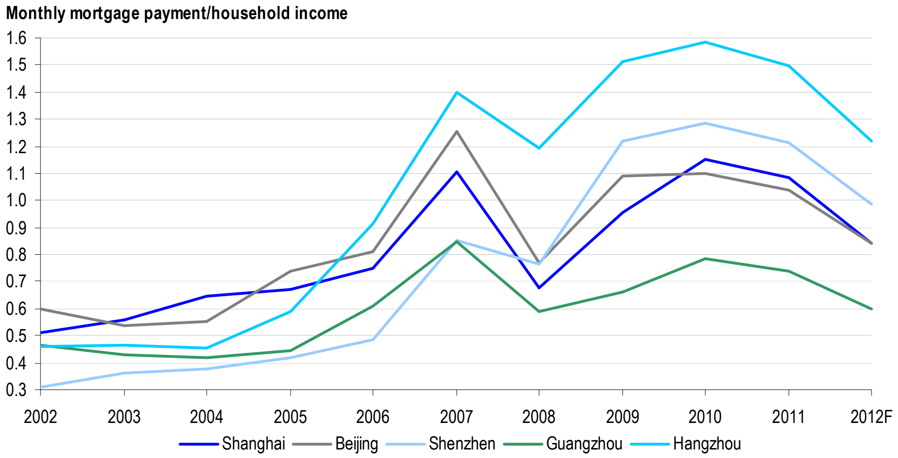
The heavy price cuts in the property market in 1Q12 are likely to continue in 2Q12 so that developers can raise funds to improve their cash flow positions. **SOE developers with low gearing should be able to outperform their peers.** China should begin to see excess demand for residential units rather than new completions in 2013 and 2014. This will lead to a reduction in the inventory of unsold units as well as improvement in the risk profile of the sector. The market is most likely to reflect the excess demand in 2H12, at which time affordability ratios across the nation should improve, moving from 2H12 levels to levels closer to what we saw in 2005 and 2006 amid property price cuts and rapidly rising personal income. This, in turn, will drive up transaction volumes. We expect China property stocks to consolidate in 2Q12, but investors should accumulate them in late 2Q12 in anticipation of a recovery in 2H12. In our view, CR Land (1109 HK, Outperform) and China Overseas (688 HK, Neutral) provide investors good investment opportunities.

Supply and demand for residential housing in China



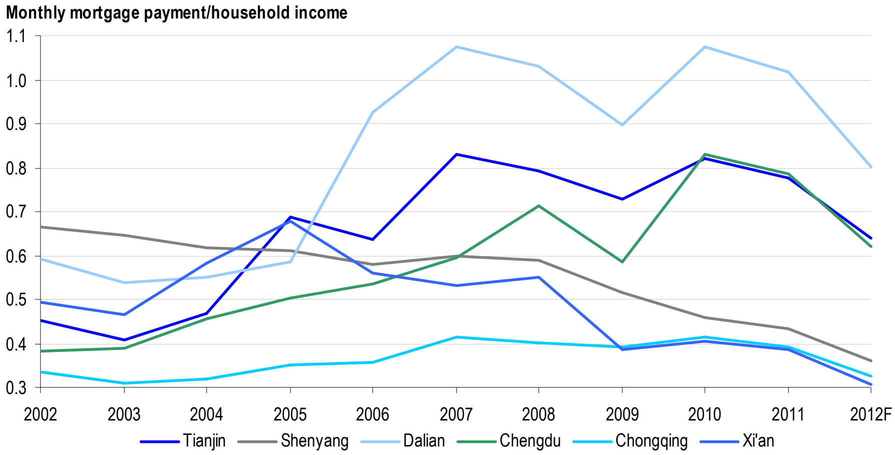
Source: CEIC, CCBIS

Affordability ratios for residential housing in tier-one cities in China



Source: CEIC, CCBIS

Affordability ratios of residential housing in tier-two cities in China



Source: CEIC, CCBIS

Theme 3: Financial reform prospects

Speaking at the NPC in March, Premier Wen Jiabao stressed the importance of China's policy of "internationalizing" the renminbi. He also lent his support to Hong Kong becoming the primary off-shore centre for renminbi transactions. As China hopes to transform Shanghai into a major international financial centre for renminbi transactions by 2015, greater effort is likely to be made towards accelerating the financial reform process, including the following initiatives.

More funds to go overseas

1. Gradually liberalizing interest rates;

2. Further liberalization of the capital and financial markets to allow more foreign participants in addition to opening financial operations to private mainland enterprises, which in turn would lead to greater competition within the financial sector;

3. Encouraging international capital inflows and relaxing capital outflows to expand quotas for QDII and QFII or renminbi-QFII;

4. Encouraging more domestic enterprises to invest in or undertake M&A overseas, with renminbi funds raised domestically or off-shore;

5. Offering more renminbi products (commodity, bonds, equity or derivatives) onshore or offshore;

6. Allowing more domestic enterprises to raise funds through bond issuance or IPOs (in renminbi) in the Hong Kong and overseas markets rather than letting them absorb liquidity in the domestic market;

7. The approval for Wenzhou to become the site of the individual overseas investment pilot program. The implication is that China is cognizant of the risk that excess liquidity in the country could lead to uncontrolled speculation and therefore needs to be diverted overseas. We anticipate more cities, such as Shanghai and Tianjin, will be granted similar status.

B share market defies the "principle"

We also anticipate reform within the B-share market in 2012, with the ultimate aim of removing this asset class, as B-shares become inadequate to the task of helping corporations to raise new funds. B-shares trade on the same exchange as A-shares do, but at different prices and currencies while possessing the same voting rights as A-shares. This flies in the face of the principle of "same share-same rights". Prices of B-shares, currently trading at a 40-80% discount to their counterparts in the A-share market, may experience a strong rebound and move closer to A-share prices should reforms be implemented within the B-share market. **Year-to-date, the B-share indices in Shenzhen and Shanghai outperformed the A-share indices by 10.1% and 4.1%, respectively.**

In our view, China's financial reforms should result in increasing activity within the capital and financial markets to the benefit of financial services companies, particularly in the area of stock-broking, fund management and insurance. However, banks may suffer as more private companies start to compete with the banks causing bank interest margins to narrow on disintermediation or interest rate liberalization.

In the longer term, we believe accelerated financial activity and reform increase the number of high-income professionals in China, leading to greater demand for luxury products and housing.

To reap the benefits of financial market reforms and renminbi internationalization, we recommending starting with **HKEx (388 HK, Neutral)**, which is in a good position to benefit as it offers a broad range of investment products to absorb excess liquidity in China. **CITIC Securities (6030 HK, Outperform),** with a leading position in the securities industry, is also well positioned to benefit from upcoming reforms.

Sector recommendations

More sector rotation activities in 2Q12

We expect Hong Kong's stock market to consolidate in early 2Q12. Even with the introduction of an RRR cut, market participants may take advantage of any stock price rebound and offload their holdings in sectors with slowing earnings momentum.

We believe mid-to-late 2Q12 presents a good opportunity to accumulate stocks for mid-term investment amid what we believe will be an earnings recovery. We recommend overweighting consumer discretionary, consumer staples, capital goods, insurance and financial services, and technology stocks. Meanwhile, we downgrade the banking and materials sectors to Neutral.

CCBIS sector ratings and recommendations

Sector	Weighting	Beneficiaries	Remarks and timing of action
Consumer discretionary	Overweight	Belle (1880 HK, Outperform) Springland (1700 HK, Outperform) China Lilang (1234 HK, Outperform)	Greater propensity to consume, supported by government stimulative policies to be introduced in 2Q12
Consumer staples	Overweight	Vinda (3331 HK, Outperform) Sinopharm (1099 HK, Outperform) Hengan (1044 HK, Not Rated)	Lower raw material prices and stable product demand
IT or technology	Overweight	Tencent (700 HK, Not Rated) AAC Technologies (2018 HK, Outperform)	Increasing consumption and government supportive policies for information technology industries. More of these policies are expected to be released in 2Q12
Capital goods	Overweight (upgrade from Neutral)	Singamas Container (716 HK, Outperform) Shanghai Electric (2727 HK, Not Rated) Boer Power (1685 HK, Not Rated) Sany (631 HK, Not Rated)	Lower material costs, reducing inventory and recovering economic activity
Insurance/financial services	Overweight	Ping An (2318 HK, Outperform) CPIC (2601 HK, Outperform) CITIC Securities (6030 HK, Outperform)	The stocks are expected to consolidate in early 2Q12 but recover after mid-2Q12 as an economic recovery may drive A-shares to higher levels. Accumulate the stocks starting from mid-2Q12
China banks	Neutral (downgrade from Overweight)	ICBC (1398 HK, Outperform) BoCom (3328 HK, Neutral)	**The sector may attract buying interest in early 2Q12** due to attractive valuations, but funds are expected to **switch to other recovering sectors after mid-2Q12 as NIM begins to narrow**, especially after anticipated RRR cuts
Hong Kong banks	Neutral	Hang Seng Bank (11 HK, Outperform)	Lacking concrete catalysts
Energy	Neutral	China Coal (1898 HK, Outperform)	High product-price uncertainty raises investment risk for oil products. Product price stability will improve within the coal sector
Autos	Neutral	Brilliance China (1114 HK, Outperform)	Seasonal slowdown in 2Q12 will cap short-term upside potential. Only the high-end segment shows resilience. Accumulate in 3Q12
China property	Neutral	CR Land (1109 HK, Outperform)	Headwinds in early 2Q12 but recommend accumulating the stocks in late 2Q12 ahead of improvements in transaction volume and affordability in 2H12.
Hong Kong property	Neutral	K. Wah International (173 HK, Not Rated)	Lacking catalysts although high property prices will continue in 2Q12
Shipping	Neutral (upgrade from Underweight)	China COSCO (1919 HK, Outperform)	Recovering demand and rising tariffs. China encourages more imports of commodities and high-tech products to satisfy rising domestic manufacturing and consumption demand
Airlines	Neutral (upgrade from Underweight)	China Southern Airlines (1055 HK, Outperform)	Distressed valuations limit downside risk. Increasing passenger numbers ahead of Labor Day in May may be a catalyst
Materials	Neutral (downgrade from Overweight)	CNBM (3323 HK, Outperform)	Year-on-year earnings momentum to slow in 1Q12 or 1H12 on lower product prices and narrower margins, especially in the case of upstream producers. New materials or cement-related stocks may perform better. Low inventory-to-sales ratio and re-stocking needs will provide support at lower levels
Telecom services	Underweight	China Unicom (762 HK, Not Rated)	Lacking catalysts and presenting unattractive valuations
Utilities	Underweight	CLP Holdings (2 HK, Not Rated)	Lacking catalysts but the stocks may show resilience in early 2Q12 when the market begins to consolidate

Source: CCBIS

China Economics

2Q12 Market Outlook

Dr. Banny Lam
(852) 2532 2578
bannylam@ccbintl.com

Rocky Zhang
(852) 2533 2411
rockyzhang@ccbintl.com

Stephanie Tong
(852) 2844 3602
stephanietong@ccbintl.com

Stimulative policies spark a recovery

- **Bumpy global economic recovery.** Although risk premium declined in 1Q12 once Europe managed to inject liquidity through two rounds of the Long-term Refinancing Operation (LTRO), the global economy is still not out of the woods. The US faces the headwinds of private sector deleveraging and the consumption recovery remains sluggish. Meanwhile, the Eurozone continues to be dragged down by dwindling credit, sovereign-debt problems and fiscal austerity. Looking east, the strong yen and a weak job market are the major impediments to growth in Japan. Emerging markets contending with the global slowdown will have to cut interest rates as they attempt to mitigate the effects of a slumping export sector.

- **China's economy to turn around in 2Q12.** Premier Wen Jiabao targeted 2012 GDP of 7.5% at the March NPC, setting low expectations for the market. 1Q12 was as tough as expected, with exports shrinking dramatically and GDP growth slowing to 7.9%. Domestic demand will be the major driver of robust 8.2% YoY GDP growth in 2Q12 when the central government releases more stimulative policies and manufacturing momentum continues to strengthen on the recovery in consumption.

- **Inflation under control.** CPI peaked in 3Q11 before falling to 3.8% YoY below the government's 2012 target of 4% YoY. Being the major driver of higher-than-expected CPI in March, food prices remained stubbornly high, especially vegetables, which soared 20.5% YoY in March compared with 6.5% in February. We look for overall 2Q12 inflation of 3.9% YoY, similar to what we saw in the first quarter of this year when China's central bank had ample scope to unwind its tight credit regime. We look for **one 50 basis-point RRR cut in April** aimed at increasing liquidity and encouraging greater lending to cash-strapped firms.

- **Consumption starts to boom in 2Q12.** Our analysis indicates that consumption will be China's most powerful growth driver in 2012, supported by rapidly increasing household income and growing private spending. As highlighted at the March NPC, the Chinese government will implement fiscal policies to spur domestic consumption, including the first national "consumption promotion month" scheduled to last from 2 April to 4 May this year. It will coincide with more policies designed to encourage spending on services, energy conservation products and domestic branded products.

- **Strong investment sustains.** We are positive on FAI growth momentum in 2Q12 on the basis of: (1) continued social economic housing construction; (2) further monetary loosening in April in the form of one RRR cut; (3) government investment in new strategic industries as part of the 12th Five-year Plan (FYP); and (4) infrastructure investment towards accelerating urbanization. These factors put our 2Q12 FAI forecast at 22.3% YoY, slightly higher than 21.8% YoY growth in the first quarter.

- **Export slump maintains.** The role of exports as the driver of China's economic growth is exaggerated. We predict a narrowing trade surplus for 2012 as China shifts focus from exports to consumption. However, we forecast the trade deficit will persist into 2Q12 as the anemic recovery in the US is unlikely to offset the overall economic slowdown in most emerging countries where demand could shrink faster than expected.

Global economic outlook in 2012

Global economic outlook improves but growth still sluggish

2Q12 will continue to see the US struggle to recover despite a surprising 1Q12. There remains considerable slack in the economy and inflation is running below the Fed's goal in the medium term. In Europe, rescue strategies, including two rounds of the ECB's LTRO and the second aid package to Greece seem to be working but the region has not yet climbed out of the pit of debt it is in. Japan's recovery is moving along at a snail's pace, despite monetary easing announced by the Bank of Japan. The yen is strengthening and unemployment is still high amid a deflationary environment. As for the emerging markets, we maintain our view that further monetary stimulus, e.g. rate cuts, will be introduced by countries facing "controllable" inflation in order to more effectively contend with the global slowdown.

Global GDP forecasts

% (otherwise stated)	2011A	2012F
US	1.5	2.2
Euro area	1.6	(0.3)
Germany	2.7	0.7
France	1.7	0.2
Italy	0.6	(1.5)
Spain	0.8	(1.1)
Greece	(5.0)	(4.5)
Portugal	(2.2)	(1.8)
UK	1.1	0.8
Japan	(0.5)	2.2
Hong Kong	5.0	3.5
Singapore	5.3	3.0
Russia	4.3	3.5
India	7.8	7.0
Brazil	3.8	3.3

Source: IMF, CCBIS estimates

US: 1Q12 a positive surprise but recovery still sluggish

US economic momentum is picking up, albeit slowly

1Q12 began with a bang, with equity markets rallying by around 5.8% YTD. Risk appetite seems to have improved after the trough in October 2011. Hopes for another quick-fix, i.e. Quantitative Easing 3 (QE3), dissipated as Federal Reserve Chairman Ben Bernanke gave no sign that there would be another round of quantitative easing at the most recent FOMC meeting. The result was profit-taking by investors who had originally priced in a cash injection. Now that the excitement of the rally in 1Q12 has died down, in 2Q12 we expect the market to refocus on economic fundamentals, including unemployment, housing, capital spending, trade and consumption.

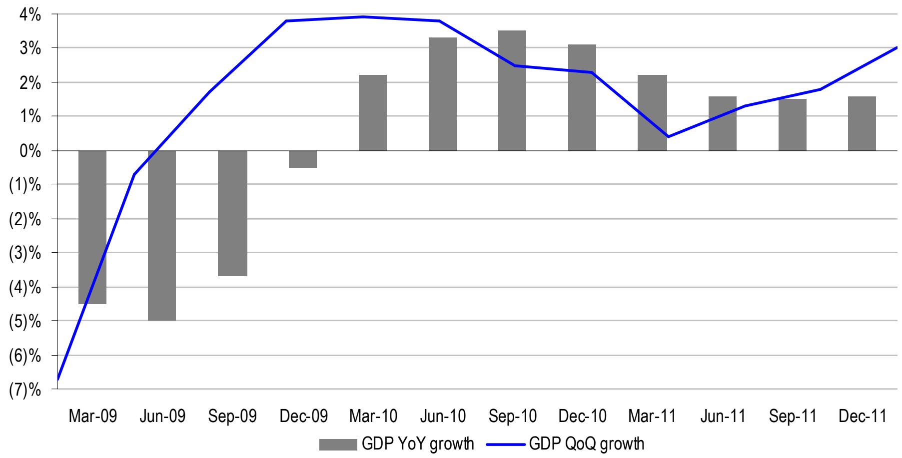
Our outlook for US GDP is that it will expand in 2012 at around 2.2% YoY. We believe the fallout from the financial crisis leaves the US mortgage market impaired and consumers preoccupied with remaining financially sound. Some improvement should come from increased individual savings, instead of through rising holdings on equity and real estate. There are now many signs indicating that US economic growth will be sluggish in 2Q12. Thus, we remain vigilant for any signal that the economy is losing steam – an event that would spur the Fed to further action, e.g. QE3 or Operation Twist 2 (OT2). The expiration of the current Operation Twist at the end of June 2012 could be one such event.

GDP tracker – expected to slow on stock build-up

Real GDP slows due to destocking

Although real GDP grew at 3% YoY in 4Q11, about 2% out of that 3% YoY growth can be attributed to stock build-up. As destocking begins, the apparent "robust expansion" will disappear, causing real GDP to grow at a slower pace.

US economic growth seems improving despite an overall weakness in 2011



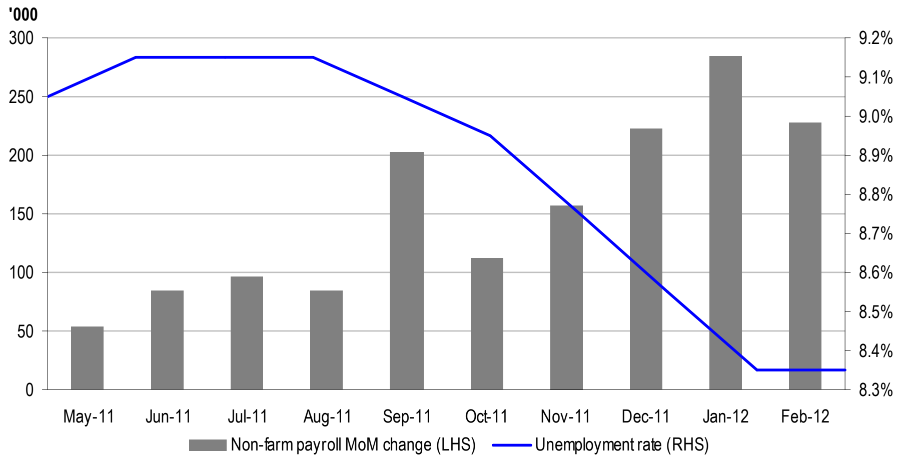
Source: Bloomberg

Unemployment – moderately stabilized

Unemployment stabilizes

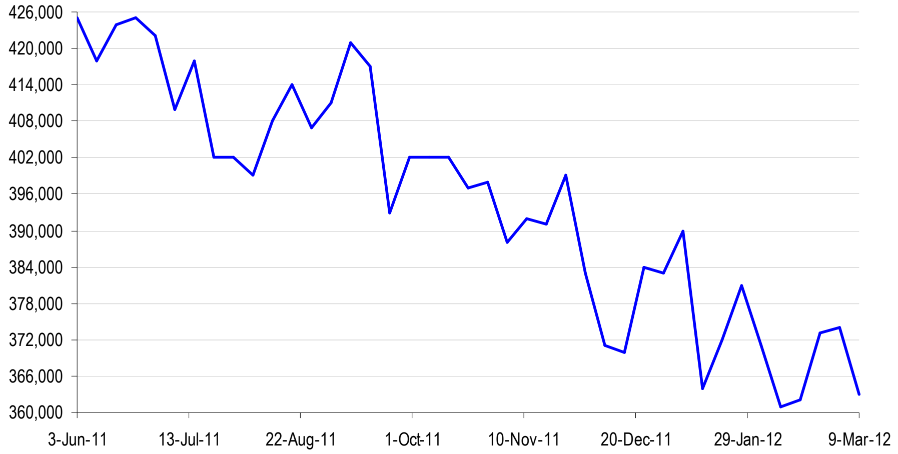
The jobs market has improved, with the labor market data ending stronger than expected in the first two months of 2012. The unemployment rate has been holding at 8.3%, while initial jobless claims have been improving week-on-week in 1Q12. Non-farm payroll employment has also shown substantial progress in 1Q12.

Jobless number falls as non-farm staff enjoy payroll increase



Source: Bloomberg

US initial jobless claim substantially slowing since the start of 2012



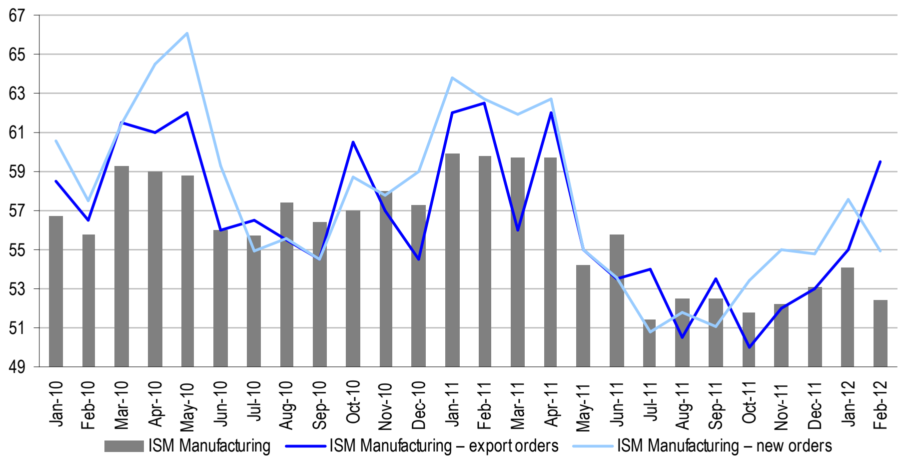
Source: Bloomberg

Stronger-than-expected new export orders

Manufacturing activities – export order-driven growth

We remain cautious over manufacturing activity and capital spending. New export orders grew from an average of 54.4% in 4Q11 to 54.9% in February 2012, causing a much stronger-than-expected bounce in new orders. However, PMI remained at around 52.4% in February 2012, indicating that the positive export orders have not yet had an impact on the slow yet healthy PMI.

Slow but growing manufacturing activity driven by positive export orders



Source: Bloomberg

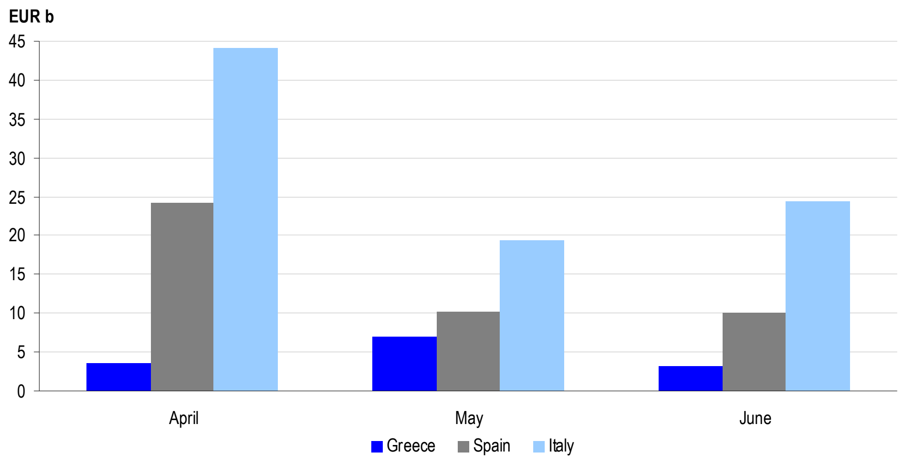
EU: Rescue strategy working but Europe not yet out of the woods

Europe steps back from the cliff

With the tumultuous conditions of 2011 still fresh in their minds, investors remained anxious in 1Q12. In all, 1Q12 can be characterized by problems similar to what were seen in 2011: overleveraging, loss of capital market access and a persistent solvency crisis. From a wider perspective, the combination of debt crisis and economic recession in the Eurozone late in 2011 has left investor risk sentiment at a record high.

Market performance in 1Q12 has set the tone for 2Q12, driven by the release of 2011 corporate results and 2012 forecasts. However, the macro environment will remain a major driver for the markets. There is a large amount of Eurozone government debt to be refinanced in 2Q12. Although the EU crisis has been relatively subdued in the past month, concerns over whether or not the EU can completely cover its debts in 2Q12 can quickly bring attention back to the solvency problems.

2Q12 debt maturity schedule for Greece, Spain and Italy



Source: Bloomberg

We believe sovereign debt woes have been alleviated substantially due to the European Financial Stability Facility (EFSF)'s rescue programmes for Europe's struggling nations and the two rounds of ECB's LTRO. The relief can be observed from the improvement in some peripheral CDS spreads. Yet many risks persist, such as the lack of proper implementation of reforms and the lack of large credible buyers of last resort for the sovereign debts. The other risk is that the bigger borrowers such as France and Italy have seen credit ratings cuts earlier in January 2012. However, we believe that market worries seem to have more to do with over-exaggerated fears of contagion than well-founded fears concerning solvency.

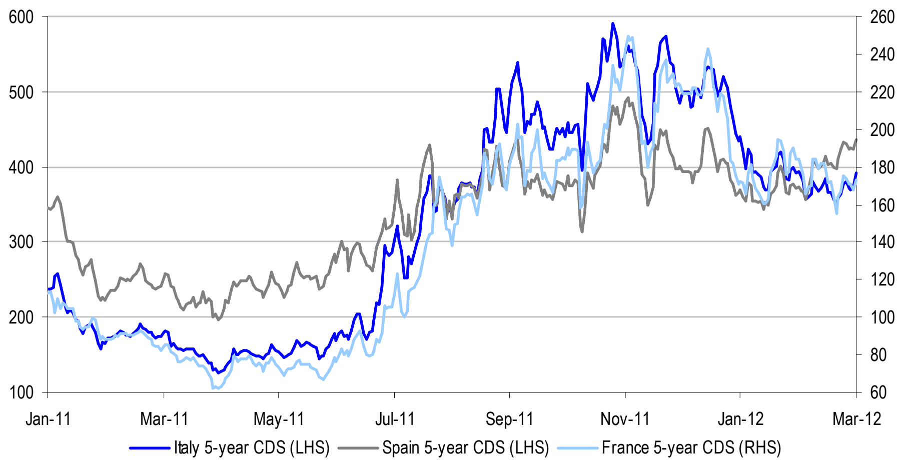
Ratings and debt of major European countries

Country	5-year CDS*	S&P	Agency ratings Moody	Fitch	Total debt amount* (US$m)
Portugal	1093.57	BB	Ba3	BB+	228,750
Ireland	572.08	BBB+	Ba1	BBB+	162,619
Spain	436.3	A	A3	A	951,149
Italy	395.17	BBB+u	A3	A-	2,190,855
Iceland	275.13	BBB-	Baa3	BBB-	19,578
Belgium	233.69	AAu	Aa3	AA	438,026
France	172.44	AA+u	Aaa	AAA	1,791,689
Austria	161	AA+	Aaa	AAA	266,899
Netherlands	124.24	AAAu	Aaa	AAA	418,199
Denmark	117.22	AAA	Aaa	AAA	139,625
Germany	75.5	AAAu	Aaa	AAA	1,455,553
Finland	68	AAA	Aaa	AAA	105,291
United Kingdom	64.29	AAAu	Aaa	AAA	1,855,531
Sweden	43.32	AAA	Aaa	AAA	144,904
Switzerland	41.4	AAAu	–	AAA	113,479
Norway	22.5	AAA	Aaa	AAA	67,308
Greece		SD	C	B-	310,994

** Data as of 11 April 2012*

Source: Bloomberg, CCBIS

CDS stooped with the major overhang on Greece gone



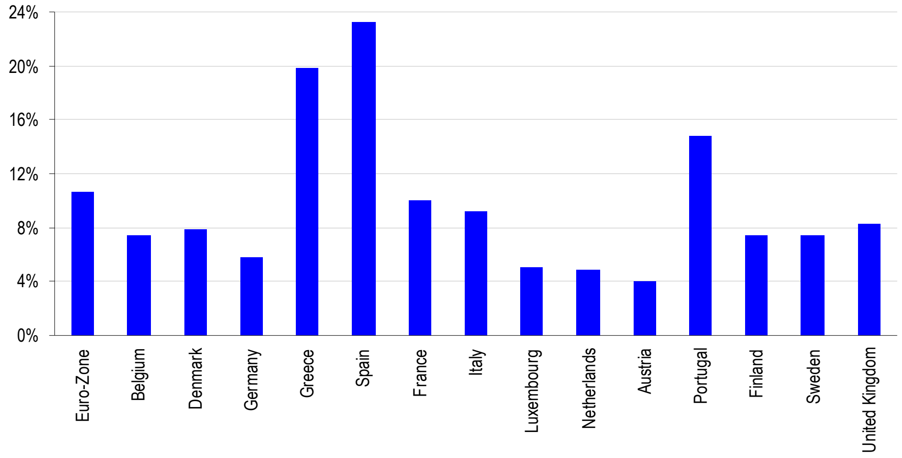
Source: Bloomberg

Prospect of temporary removal of overhang for Greece

Greece – temporary removal of overhang

In 1Q12, debt-stricken Greece finally received some positive news beginning with its current account deficit, which fell 46% YoY to EUR1.5b in January 2012. The debt situation also improved as the second aid package amounting to EUR130b had been approved on 21 March 2012. A debt restructuring plan was agreed upon by all parties concerned. Part of the plan includes a commitment by Greece made in March this year to reduce EUR100b of its debt. And as Greece approaches the deadline for repaying EUR14.5b in maturing debt, it finally received its first tranche of aid amounting to EUR5.9b from the ECB and EUR1.6b from the IMF on 19 March, enabling an orderly payout of its maturing debt and CDS, giving it a welcome respite in 2Q12.

Unemployment rates of EU member states



Source: CCBIS estimates

Spain now in the hot seat

Spain – now in the hot seat

The focal point of the European debt crisis has moved from Greece to Spain. The latter is contending with a downturn, the worst unemployment among all EU member countries, and mounting debt. According to the Spanish Central Bank, the country's non-performing to outstanding loans ratio was up from 7.61% in December 2011 to 7.9% in January 2012, a 17-year record high since August 1994. Throwing salt on its wounds, Spain is also due to repay EUR42.8b in 2Q12.

Italy needs to repay EUR87.8b in 2Q12

Italy – 2Q12 is critical

After Greece and Spain, the next looming debt crisis is Italy. Similar to the situation in Spain, unemployment in Italy shows no signs of improvement, with the February figure reaching an 11-year record high of 9.2%. Adding to its worries is the fact that it is due to repay EUR87.8b of debt in 2Q12, about double the amount that Spain has to repay. Naturally this is cause for concern for the market as there does not seem to be any new financing tools once the ECB is finished with the second round of the LTRO.

Italy's 10-year yields still at low range

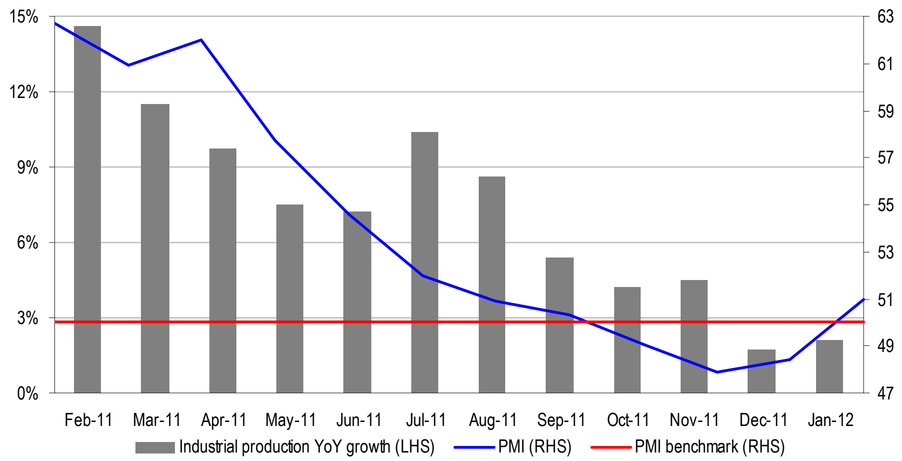
Source: Bloomberg

Germany's economic growth is still weak

Germany – recession risk has receded but growth still anemic

The German economy is regaining some momentum as we have seen the business climate index rise for four consecutive months. The PMI remains low, albeit healthy, at 50.2, slightly above the threshold of 50, reflecting marginal expansion of manufacturing activities. Nevertheless, orders and retail sales are struggling, a sign that consumer and business confidence has not yet recovered. The only positive surprise was from January industrial production, with favourable weather playing a major part. Overall, economic growth in 2Q12 is likely to continue at a very gradual pace. However, we believe that the risk of GDP decelerating once again in 1Q12 after -0.2% growth in 4Q11 is remote.

Germany shows positive industrial production but a slow PMI



Source: Bloomberg

Now that the second aid package for Greece and the debt rescheduling agreement with private creditors have been agreed upon, there is a greater chance of the EU debt crisis being contained in 2Q12. The latest fund-raising activities by the EFSF, including: (1) the sale of EUR1.0-1.5b in 20-30 year bonds on 19 March; (2) the sale of EUR2.0b in 6-month bills on 20 March; and (3) the sale of EUR3b in benchmark 5-year bonds on 20 March, have all been well received by investors. Despite Greek debt spilling over to Spain, the long-standing conflict between all stakeholders about the Greek debt rescheduling has finally reached a compromise. Going into 2Q12, we expect that the main themes that prevailed in 2011 will persist in 2012, including little-to-zero growth, high unemployment and a lack of investor confidence.

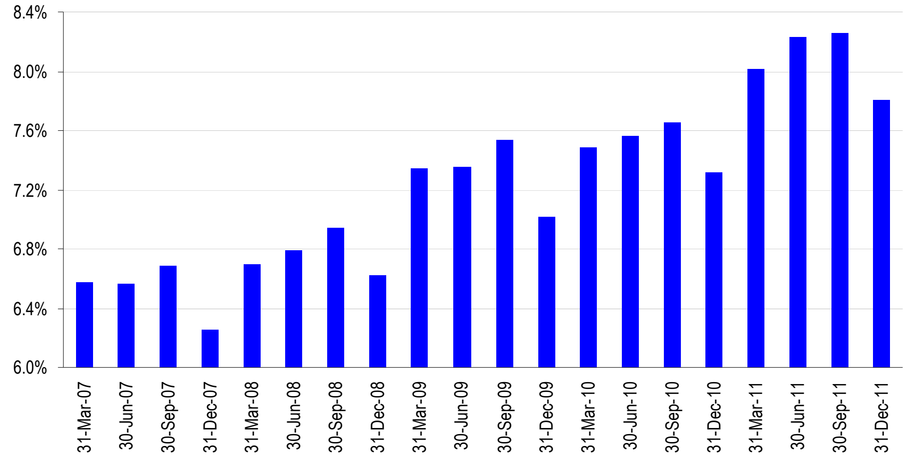
Japan: Revival seems to be slower than expected

Japan's growth momentum picks up while yen depreciates

Despite market hopes and the government efforts to reverse the trend of economic slowdown, 1Q12 is ending without Japan showing any sign of escaping from the specter of recession. High government debt, an aging population and enduring deflation continue to bedevil the Japanese economy.

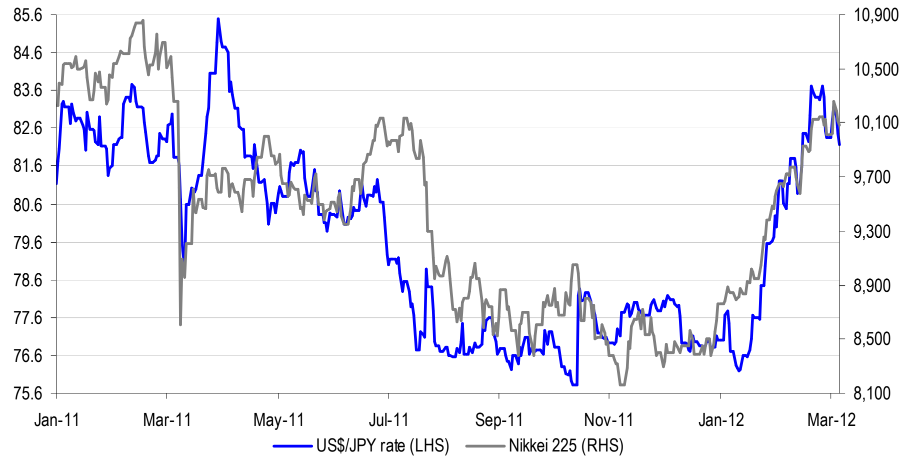
The key event in 1Q12 was the 14 February announcement by the Bank of Japan that it would "pursue powerful monetary easing" with a target of 1% CPI growth, to be achieved by increasing its limit for government bond purchases by ¥10t. However, in the absence of further measures, this amount might not be adequate to stop deflation. The risk is that as the central bank continues to print money more aggressively, the currency will remain strong, with the US and EU flooding Japan's market with new money. As such, we doubt Japan can stem the onset of deflation.

Japanese government debt to GDP reaches 220% under post-quake impact



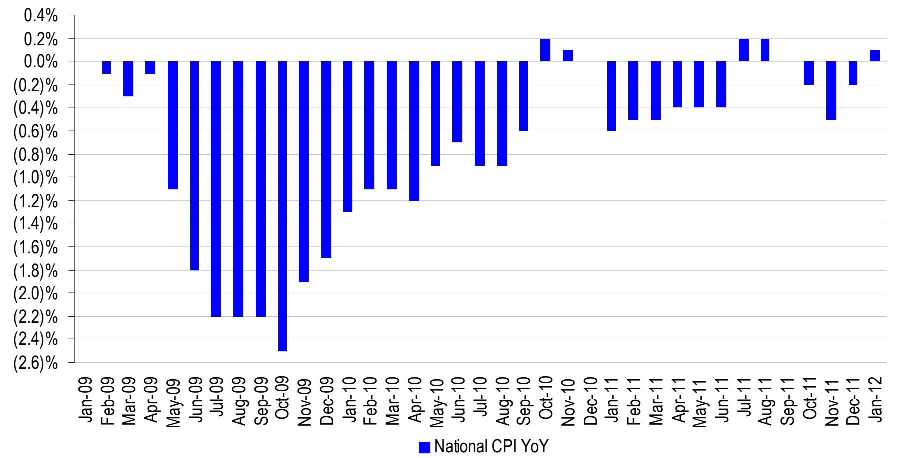
Source: Bloomberg

Robust Japanese yen driving the equity market rally



Source: Bloomberg

Japan deflation remains a persistent phenomenon

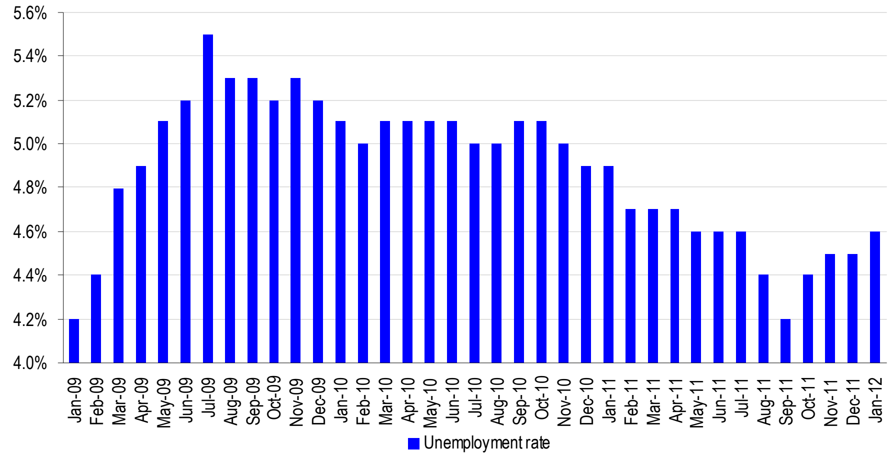


Source: Bloomberg

Another issue is Japan's rapidly aging population that is coinciding with a rising unemployment rate. The aging population will slow the progress of technological advancement, customer demand and manufacturing activity.

Mounting unemployment is the culprit behind falling consumer spending, as retail trade runs below 2.0% at 1.8% in January 2012. Merchandise trade imports are strong, however, at 9.2%. This, together with the strong yen, allows local consumers to enjoy imported goods at lower prices.

Unemployment does not show progress in 1Q12

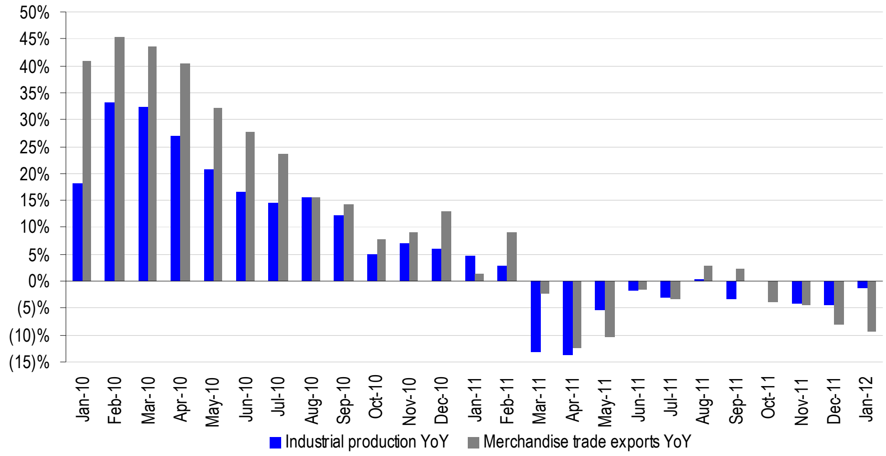


Source: Bloomberg

The outlook for manufacturing and industry is poor, although machine orders picked up 3.4% MoM in January 2012 against -7.1% in December 2011. Industrial production and exports are still negative, falling 1.3% YoY and 2.7% YoY from 2011, echoing the central bank's assessment that the "economic recovery is slowing", which is a far cry from its earlier statement that "the economy is taking off".

On a more positive note, the outlook for trade is improving as exports growth picked up from -9.3% YoY in January 2012 to -2.7% YoY in February 2012. Imports growth also remained above 9.0%. In addition, the trade balance recovered significantly back to positive territory, after being negative for the previous four months. Thus we maintain our positive outlook for Japan's trade conditions.

Industrial production and exports still below water



Source: Bloomberg

Despite a series of measures undertaken by the government to bring some life back into Japan's faltering economy, there is as yet no sign that the economy is picking up. More likely is that it will level off in 2Q12. Yet we remain positive for Japan in the long run, as it will be a beneficiary of emerging market demand and its own post-quake reconstruction.

Emerging economies: Focus switched from inflation to growth

Slowdown in emerging economies prevails, prompting them to switch their monetary policy from "tight" to "loose"

Out of all external macro indicators, inflation was the main metric for investors to gauge the market in 1Q12. For inflation-sensitive markets like India, Singapore, Thailand, Brazil and other ASEAN countries, high inflation usually drags down their fiscal and current account balances. India's trade deficit continued to widen in 1Q12 and its currency rupee kept depreciating against the US dollar since February 2012.

Most central banks in the emerging countries have already announced their monetary stimulus packages to replace tightening policies in place since late 2009. These moves are in keeping with our view that the policy focus of emerging market governments has switched from inflation to growth. For instance, Brazil and Vietnam's central banks cut their interest rates by 0.75% and 1.00%, respectively, to restore growth momentum in the wake of shrinking external demand. Following rate reductions by Singapore, Indonesia and Thailand in late 2011, India announced two rounds of RRR cuts since the beginning of the year, with the first round of 50bp taking place in January and the second round of 75bp to 4.75% taking place in March (injecting around 480b rupees of liquidity into the banking system). We expect more emerging countries to adopt accommodative monetary policies either through RRR cuts or rate cuts in an effort to brighten the economic outlook.

However, we find that Asian currencies remain attractive given their relatively high interest rates and robust growth potential. Asian equities should continue to be a compelling story for investors, in our view, provided that the Eurozone does not collapse and China maintains its proactive fiscal policy stance.

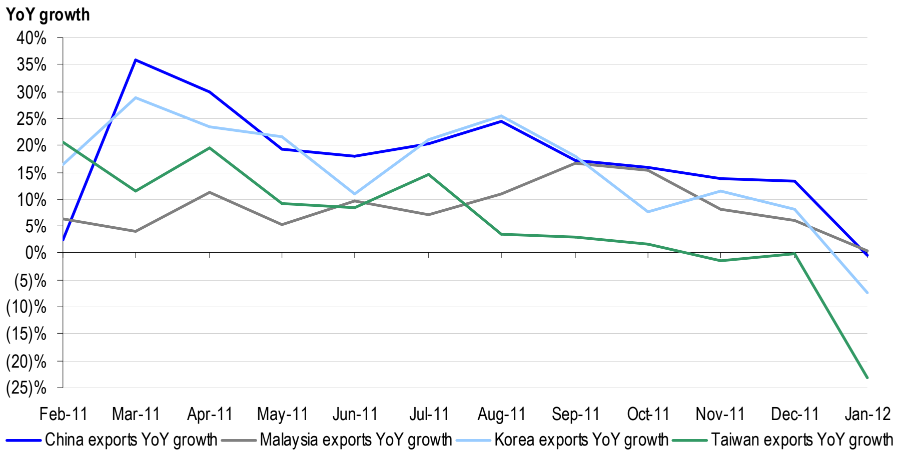
The emerging countries ended 1Q12 with easing inflation, peaking credit growth and diminishing capital inflows. Looking forward, their focus in 2Q12 will be on: (1) responding to moderating domestic demand and slowing external demand from advanced economies; and (2) dealing with volatile capital flows.

For economies where inflation is under control, their public debt is not high and external surpluses are likely to widen (including China and selected emerging economies in Asia). We look for more social spending to support poorer households in the face of weakening external demand.

For economies with diminishing inflation pressure but weak fiscal fundamentals (including those in Latin America), we expect to see a more monetary easing provided that they manage to control lending to overheating sectors, such as real estate.

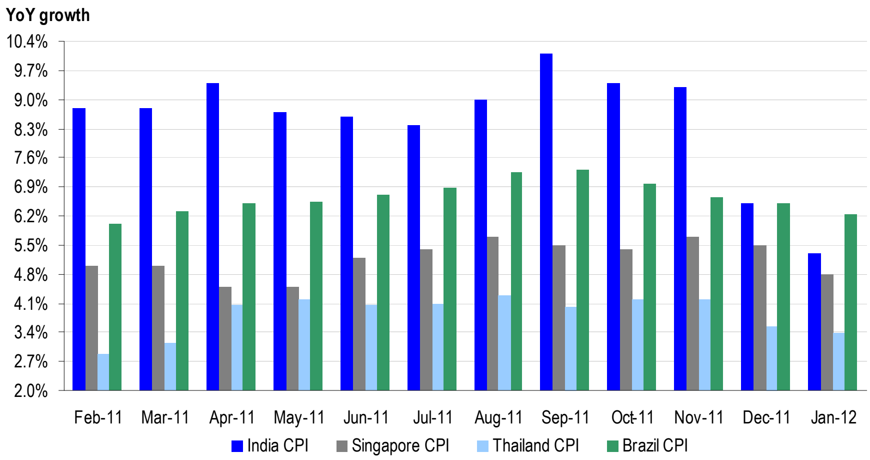
For economies suffering from high prices and public debt, including India and some Middle East countries, we will continue to see a cautious policy stance in 2Q12.

Export growth trends down in response to weakening external demand



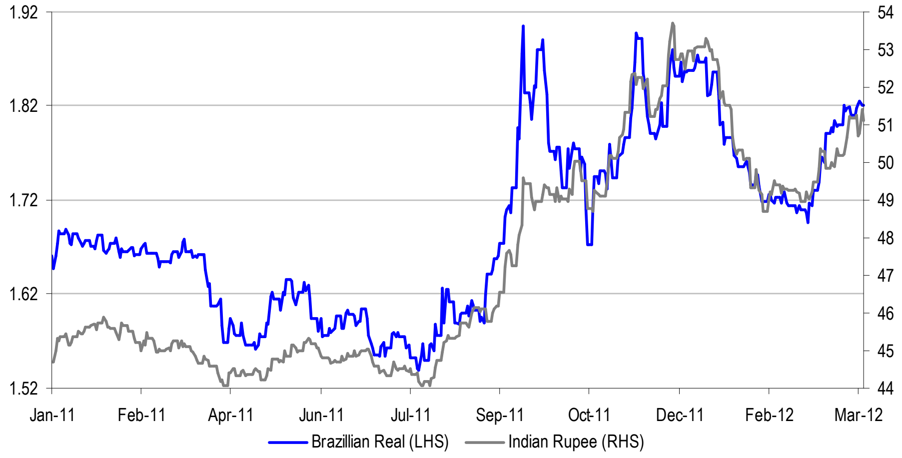
Source: Bloomberg

Inflation recently hit the roof and looks for moderation in 2Q12



Source: Bloomberg

Asian currencies look strong



Source: Bloomberg, CCBIS

China – moderated growth under control

2Q12 GDP growth accelerates moderately

As China enters the second quarter of the second year of its 12th Five-Year plan, the country finds itself facing a more stable international economic environment as concerns over the European financial crisis softened in late 1Q12 once Greece received approval for the second bailout from the Euro group. This is not to say that economists are unconcerned about China's unbalanced economy. China still has a heavy reliance on investment and exports, both of which are gradually running out of steam. Pessimistic players even anticipate a hard landing for China's economy in 2012 as weak overseas demand chokes off the export sector (year-on-year growth declined from 20.3% in 2011 to 8.9% in March 2012) and as the fall in industrial production growth falls further than expected (it fell from 13.9% in 2011 to 11.4% in January-February 2012). We remain confident that China has a sound economy and is growing in a sustainable way supported by expanding consumption, stable investments and soon-to-be-launched stimulative policies.

Fundamentally, China's sound fiscal position and low debt levels will allow it to boost the economy whenever necessary. However, over-investment leading to high inflation has alerted Chinese leaders over the past year. Beijing is now allocating money towards the agriculture, consumption and strategic industries through tax reduction and subsidy programs. Monetarily, tamed inflation and moderated economic activity in the first two months of 2012 have already created room for at least two more RRR cuts this year. We forecast China will announce **a 50bp RRR cut in April** to ease liquidity and spur domestic consumption before the Labor Day holiday in May.

Government puts more focus on boosting growth

Government's focus veered to growth from inflation

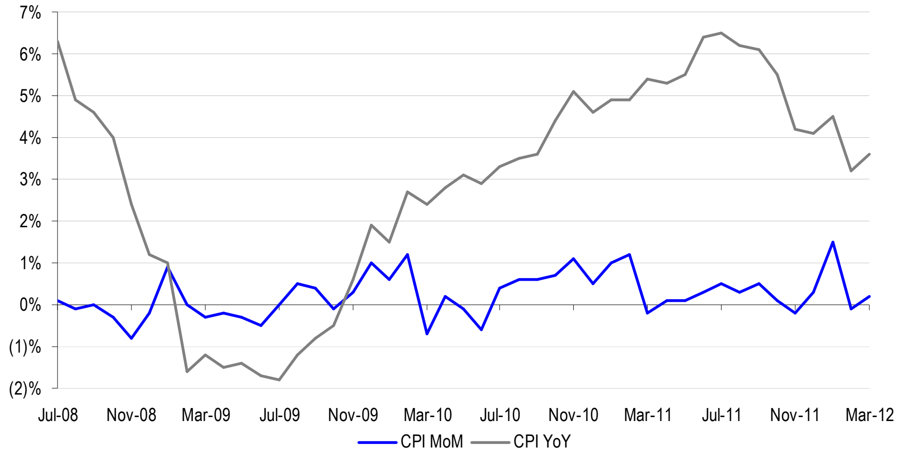
China is restructuring its growth model from export/investment-oriented to consumption-driven as external demand shrinks. In his speech delivered at the NPC in March, Premium Wen Jiabao presented a conservative economic growth target of 7.5% for 2012. This is the first time in eight years that China has set its GDP target below 8.0%, signifying its concern over uncertainty in the external environment and China's shift of focus from the quantity of growth to the quality.

A tough 1Q12 paves the way for the downgrade of the GDP target. The decline in export growth in the first quarter dragged down China's economic performance in the same period, when we anticipate GDP to expand only 7.9% YoY. With more stimulus policies in the pipeline, we believe economic growth will rebound to 8.2% YoY in 2Q12 on the back of strong retail growth and government investments.

Inflation is no long a priority yet still a key concern for China's policy makers. China's CPI rose 3.6% YoY in March from February's 3.2%, mainly due to the seasonal rebound of food prices and high oil prices. Food inflation rose to 7.5% YoY in March against 6.2% in February, mainly due to strong vegetable prices (up 20.5% YoY in March vs. 6.5% in February) and pork prices (up 11.3 % YoY in March vs. 15.9% in February). 1Q12 CPI grew at 3.8% YoY, falling within the government's comfort zone between 3% and 4%.

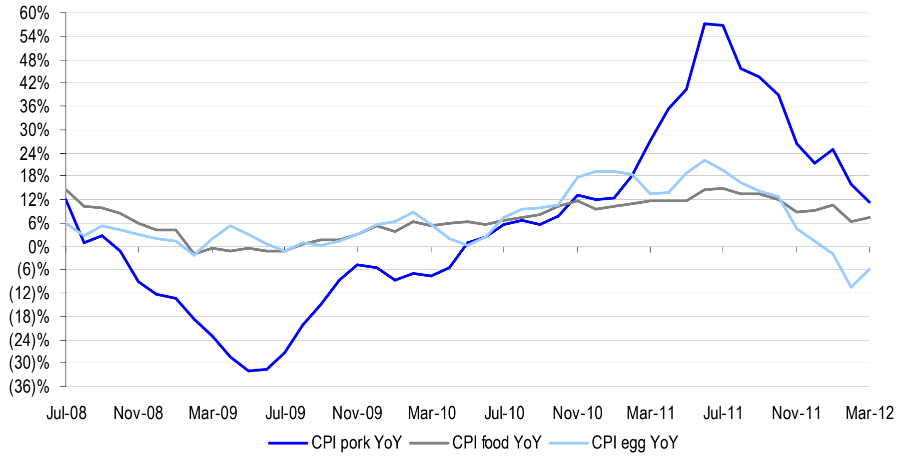
We believe price pressure, especially from food prices, will moderate over the remainder of the year, giving Beijing flexibility to its ease policy to support growth through a 50bp RRR cut in April. As GDP growth is expected to recover in 2Q12, CPI inflation will move up to 3.9% in the same quarter, in our view.

CPI slowed down in 1Q12 from the peak in 2H11



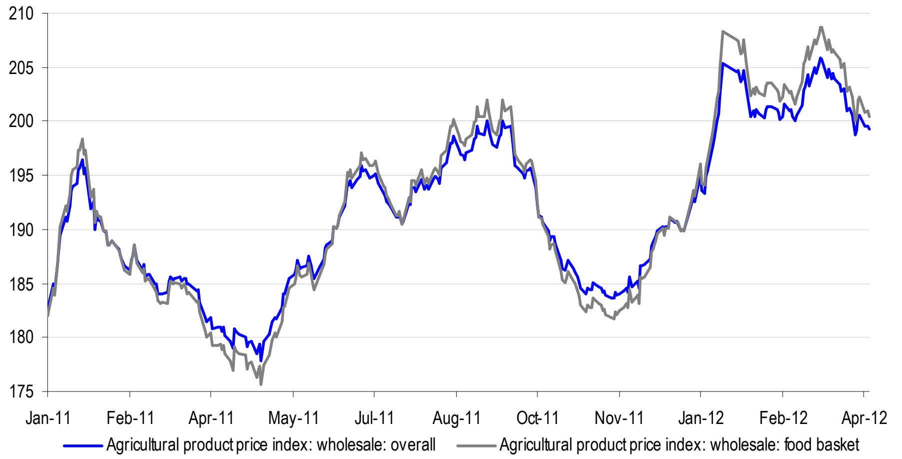
Source: CEIC, CCBIS

Food prices the major trigger for high inflation in the past months



Source: CEIC, CCBIS

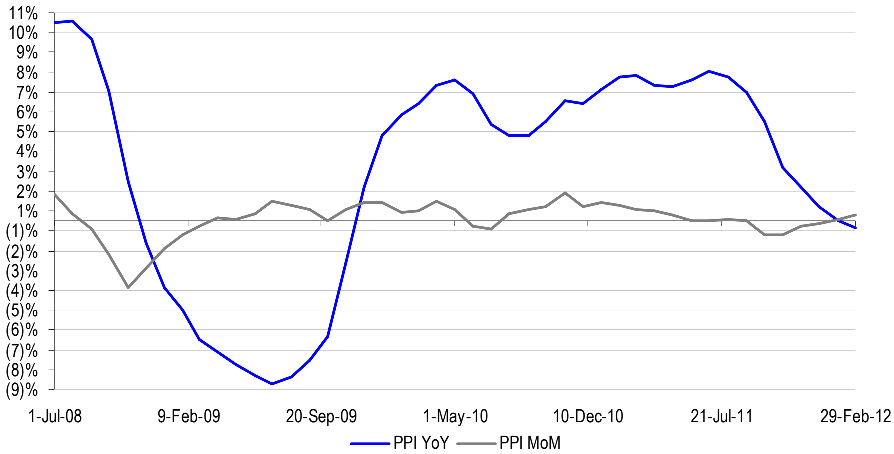
Agriculture product prices remain high in March 2012



Source: CEIC, CCBIS

China's PPI growth slowed to 0.7% in January and further eased to 0% in February and -0.3% in March, the lowest level since December 2009. Despite a relatively high base in 2011, we do not expect to see a further decline in the PPI as global commodity prices, especially crude oil, have rebounded since January 2012 on the Iranian nuclear crisis. Global crude oil prices moved steadily to above US$105/barrel over the last two months. Meanwhile, China's National Development and Reform Commission (NDRC) raised both the domestic prices of gasoline oil and diesel oil by RMB600 per ton on 20 March to record levels. Although this momentum will undoubtedly raise costs for domestic manufacturing and service industries, we expect the PPI in 2Q12 to remain low at around 1%.

PPI YoY and MoM rises



Source: CEIC, CCBIS

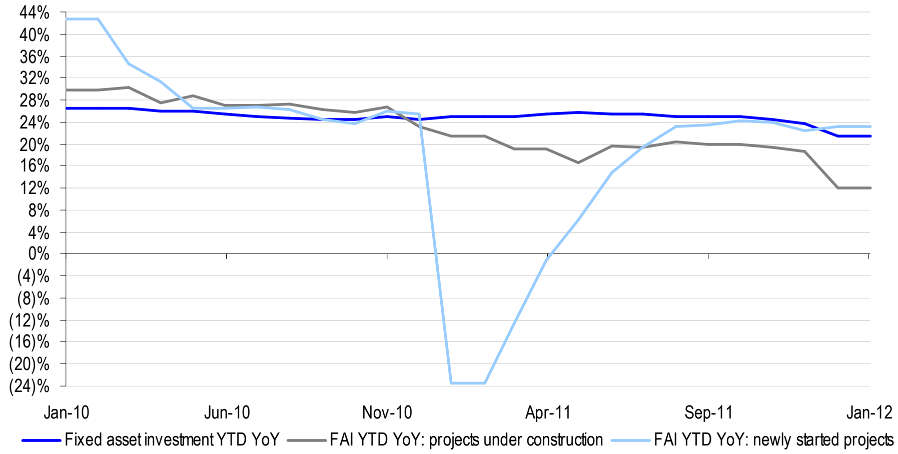
In general, we believe the Chinese government has switched its priority from inflation to growth after a series of RRR and interest rate hikes in the past two years. The lagging credit tightening effect and slower economic activity in 1Q12 have successfully brought down inflation to the government's "comfort zone" between 3% and 4%. Entering the second quarter of the year, warm weather and a seasonal decline in vegetable prices will further ease worries on inflation. Yet, as more stimulus policies emerge after the NPC, we see both consumption and government-led investment will pick up by the end of 2Q12, which in turn will support a slight QoQ increase in the CPI and the PPI in the second quarter.

Strong investment despite a slight moderation

FAI growth to remain robust in 2Q12 on strong infrastructure investment

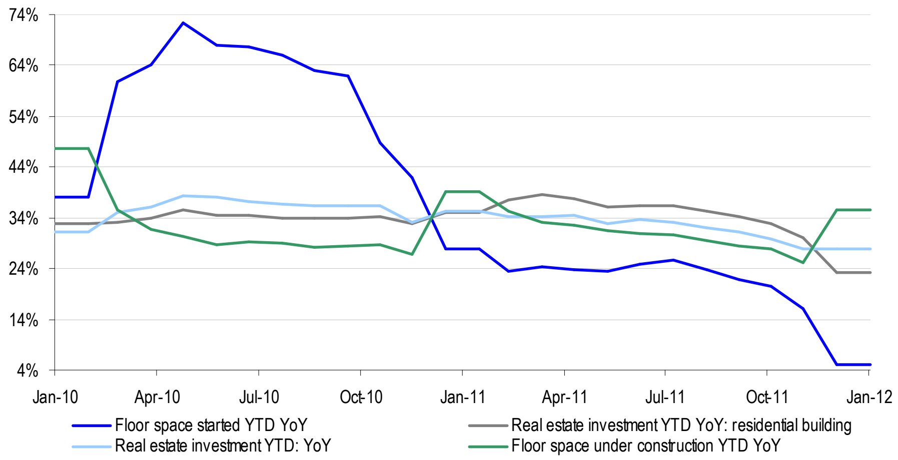
China FAI growth moderation spells a weak start of the year for manufacturers. In January-February 2012, FAI grew 21.5% YoY, down from 23.8% in 2011. Meanwhile, the NDRC also announced that China aims to tune down the expansion pace of FAI with an official target of 16% YoY in 2012. We also note that real estate investment growth remained strong at 27.8% YoY in January-February 2012 versus 27.9% in December 2011. The higher-than-expected growth of real estate investment could be in part attributable to increasing government expenditure on social economic housing, which surged 73.5% to RMB25b in the first two months of 2012. Apart from 6.1m units of economic housing carried over from 2011, the government has added 7m units of new economic housing to 2012's pipeline, and this could be a strong trigger for real estate investment growth for the rest of the year.

FAI growth and project construction



Source: CEIC, CCBIS

Real estate investment growth remained robust in January-February 2012



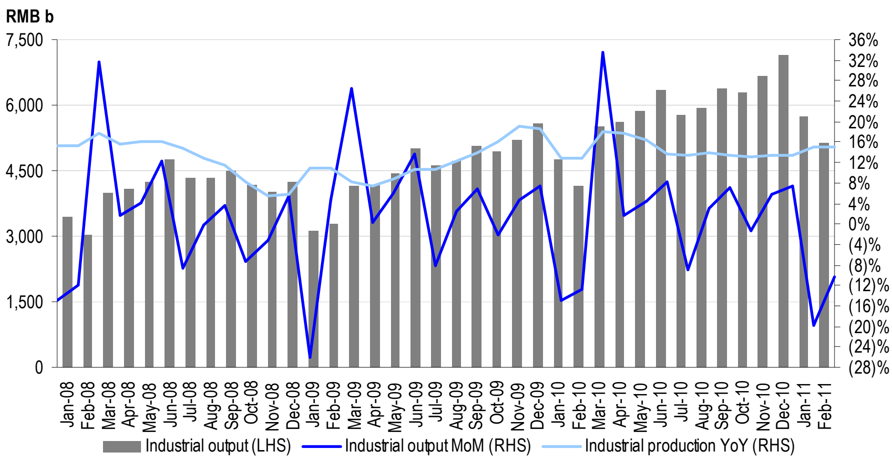
Source: CEIC, CCBIS

Besides robust economic housing investment, we are also positive for FAI growth momentum in 2Q12 primarily due to: (1) a further monetary loosening in late April as indicated by an anticipated RRR cut; (2) government investments in new strategic industries as pinpointed in the 12th FYP; and (3) infrastructure investment amid accelerating urbanization. These factors put our estimate for 2Q12 FAI at 22.3% YoY, as stable as 21.8% YoY growth in 1Q12.

China policy makers are more worried about industrial production than FAI. Industrial production increased by 11.4% YoY in January-February 2012, missing market expectations by 12.3% YoY and lower than the 12.8% YoY in December 2011. Among manufacturing sectors, automobiles, railways and transportation equipment experienced a deceleration in the first two months of the year at 5.9% and 5.7%, respectively, while textile and non-ferrous metals sustained strong production growth of 14.1% and 15.6% during the same period.

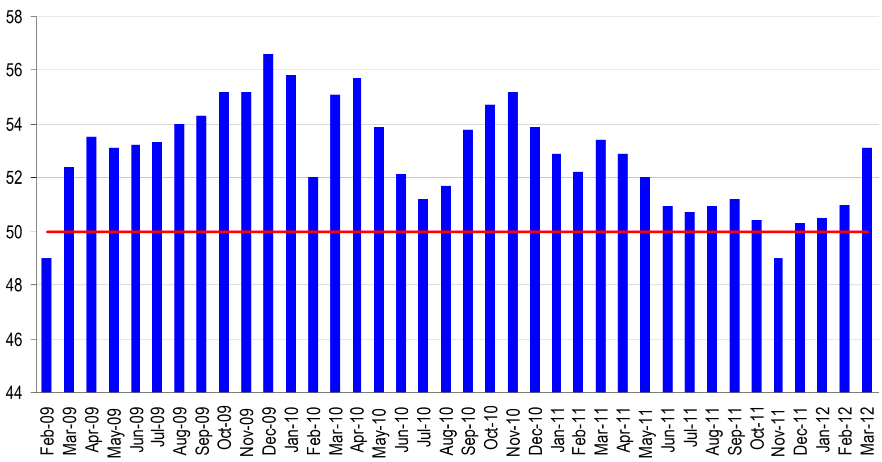
We estimate industrial production will gradually accelerate in 2Q12 to 12.5% as domestic demand increases and manufacturing activity picks up pace. The PMI purchasing price index rose in January and February, up from 47.1 in December 2011 to 50 in January and 54 in February.

Expect solid growth in industrial production



Source: CEIC, CCBIS

PMI rebounded to 50 since December 2011



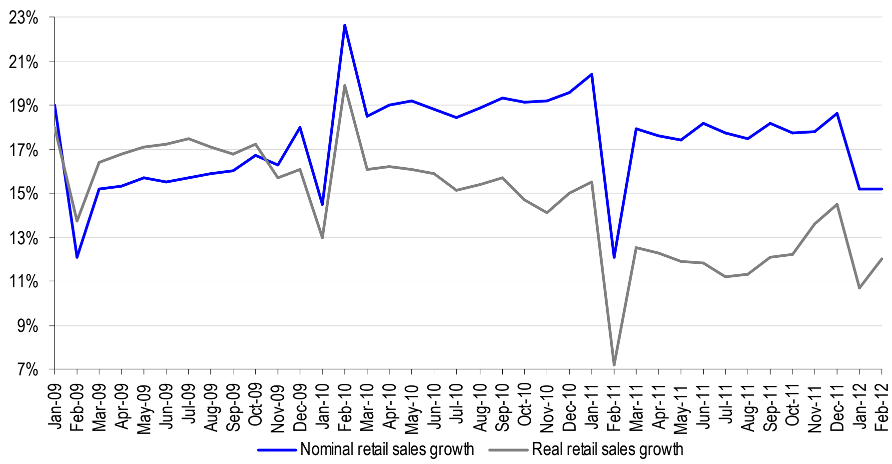
Source: CEIC, CCBIS

Consumption leads economic growth in 2Q12

Consumption to accelerate in 2Q12, driven by consumption-oriented stimulus policies

Consumption will be the spotlight in 2012 when exports are expected to continue to deteriorate and investment slackens off. 2012 started with a significant decline in retail sales, from 18.1% YoY in December 2011 to 14.7% in January-February 2012, affected by a 2.9% YoY fall in home appliances and audio/visual products and a mere 3.7% YoY growth in sports and entertainment products.

Retail sales moderated in January-February 2012

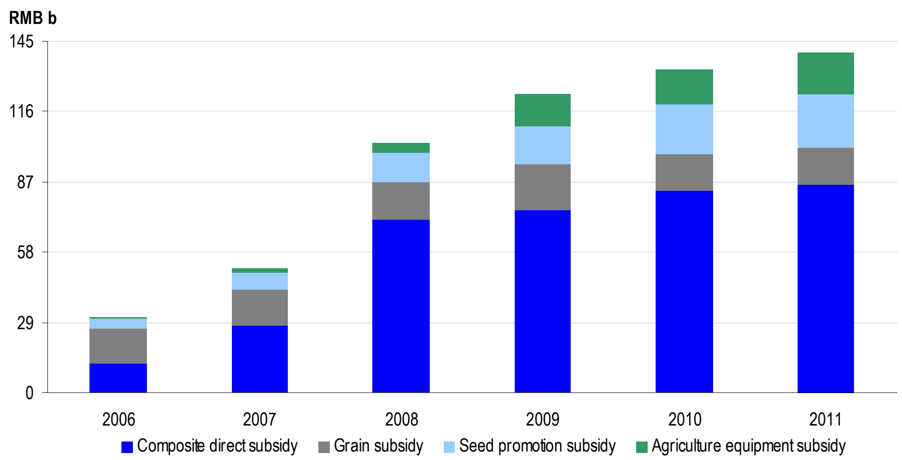


Source: CEIC, CCBIS

We believe such a slowdown in retail sales is a short-term phenomenon as early Chinese New Year in January spurred consumption in December 2011 and we expect to see a rebound of 14.8% YoY in March after the seasonality effect fades out. Our estimate calls for 15.5% YoY growth in 2Q12 against 14.8% in 1Q12 on the back of tamed inflation, growing individual income and the upcoming national stimulus policies to boost domestic consumption for the remainder of the year. From a national strategic perspective, the NPC has highlighted consumption as the primary driver of China's economic growth for the coming ten years, while the Ministry of Commerce released the "2012 consumer market development report", forecasting 15% YoY growth of total consumption in 2012.

With plenty of government subsidies poured into the agriculture sector and minimum wage increases seen in most provinces, we estimate the average wage will see double-digit growth in 2012 to improve general purchasing power and private consumption in China.

China government rapidly increased agriculture subsidies in the past years



Source: CEIC, CCBIS

With a string of consumer-related fiscal policies introduced since March, we expect more to come. The Ministry of Commerce recently launched the "2012 consumption promotion month" spanning from 2 April to 4 May to coincide with the Tomb Sweeping Day and Labor Day holidays, with an aim to spur domestic demand. The pace of urbanization and economic housing construction is also expected to accelerate in 2Q12, while government budget's funds will be used to create more consumer demand for housing-related products. The government also initiated concrete policies in specific industries, such as the furniture "go-rural" subsidy program to promote retail sales in rural areas, and we believe more policies with details will be released soon, including expansion of the experiment of the business tax-VAT reform and tax reductions.

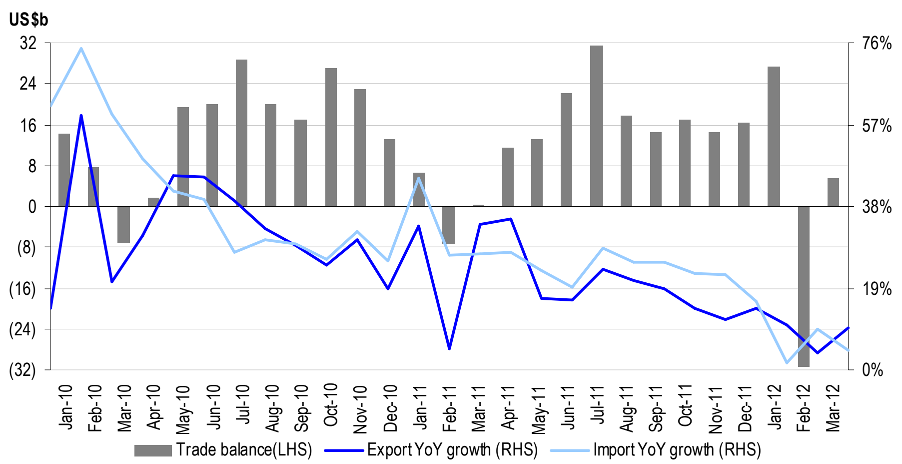
Exports remain weak, with trade deficit widening

Trade deficit will widen as exports deteriorate and imports increase

China's trade balance rebounded US$5.35b in March after its February deficit hit US$31.5b, the largest amount in a decade. Exports rose 8.9% YoY in March and imports 5.3%.

China exports increased 7.6%YoY in 1Q12, markedly lower than the 13.4% in 4Q11. However, exports in heavy industrials continued to see strength during the same period. Exports of machinery and electronic equipment grew 9.1% YoY and those of electronic appliances and equipment 6.1%. On the other hand, labor intensive sectors, including clothing (3.9% YoY), textile (1.4% YoY) and shoes (2.8% YoY) showed seasonal weakness in exports. Meanwhile, China imports rose 6.9% YoY in 1Q12, lower than the 11.8% in 4Q11. Iron ore and soybeans reported robust volume growth of 6.0% and 21.6% YoY, respectively. During the period, import prices fell 8.2% YoY. Imported machinery and electronic products rose a mere 0.5%, while imported cars rose 24.9% YoY. China's trade surplus reached US$6.7b in 1Q12, a far cry from US$47b in 4Q11 though still an improvement on the deficit of US$0.46b seen in 1Q11.

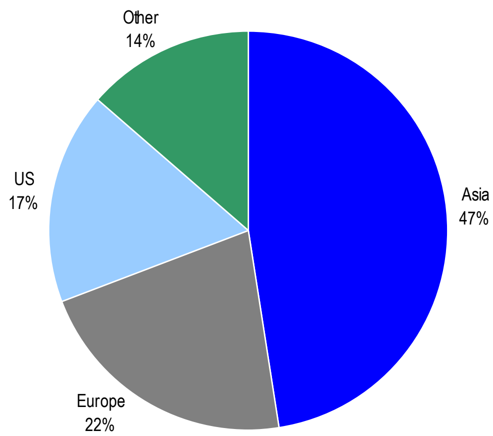
China's exports trended down in 1Q12



Source: CEIC, CCBIS

The sharp slowdown in export growth reflected weak demand from heavily indebted Europe and US in 1Q12. We predict a narrowing trade surplus in 2012 as China is twisting its focus off exports to consumption. However, a trade deficit is likely in 2Q12 as the anemic US recovery is unlikely to offset the overall economic slowdown in most emerging countries where demand could shrink faster than expected. The biggest uncertainty in exports still lies with China's largest export market Europe, who is exposed to a severe decline in activity due to debt woes. In February, China's exports to the EU contracted by 1.1% to US$19.4b YoY, while China's trade surplus with Europe fell 79% to US$1.6b.

China exports 22% and 17% of goods and services to Europe and US



Source: CEIC, CCBIS

China imports, however, could rebound in both volume and price in 2Q12, in our view. As manufacturing activity and investment into new strategic industries accelerate, we expect import demand for oil, iron ore, other commodities and industrial components to climb in 2Q12. Rising commodity prices, especially crude oil, will push up China's import growth as the country is one of the largest importers of resources.

Given the recovering economic outlook of the US and European countries, we maintain our cautious view on trade and expect exports to grow 2.9% YoY in 2Q12 and imports 6.4%.

We revise down Hong Kong's GDP growth to 3.5% in 2012, with unemployment surging to 3.8%

Hong Kong: Re-rating has begun but fundamentals remain weak

Over the past three months, Hong Kong has enjoyed positive investor sentiment and liquidity flows from developed economies, driving the equity market up in 1Q12. Since the beginning of the year, Hong Kong's equity market surged 15% to its peak in late February before giving back some of its gains to post a 10.5% YTD rise. However, economic fundamentals have failed to follow suit. We maintain our cautious tone and expect investors adopt a "wait-and-see" attitude in 2Q12. Accordingly, we downgrade Hong Kong's real GDP growth in 2012, from 4.0% to 3.5% YoY, and revise up our estimate for unemployment in 2012, from 3.5% to 3.8% YoY.

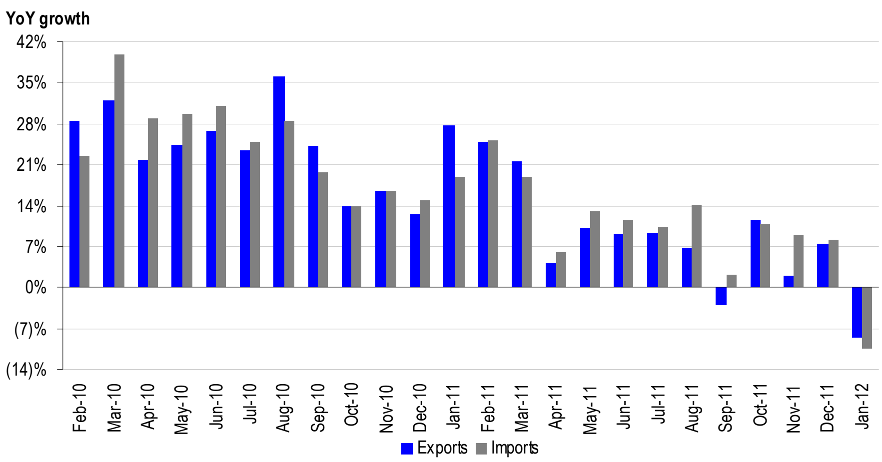
Hong Kong's 4Q11 GDP growth fell to 3.0% YoY from 4.3% in 3Q11 and 5.3% in 2Q11. In view of the poor economic growth seen in 2011, we believe growth in 1H12 will not be strong given that the EU and the US are still struggling to revive their respective economies and reverse declining exports. Hong Kong's export sector is likely to continue to be dragged down by the European debt crisis. Consumption and investment are likely to be the positives notes in 2Q12.

Exports and imports of goods and services were -8.6% and -10.5%, respectively, in January 2012, against 7.4% and 8.1% in December 2011, pulling down net exports in absolute terms. Private consumption also lost steam in 4Q11, rising only 7.1% versus 9.8% in 3Q11, as consumer sentiment began to sour. Tourist arrivals also declined, from 17.1% YoY in December 2011 to 15.3% in February 2012, with no signs of a pickup in 2Q12. Combined, weak consumption and the gloomy tourist outlook are reflected in the disheartening retail sales data for January. Value and volume of retail sales grew 14.9% and 9.1% in January 2012 against 23.4% and 17.1% in December 2011.

And the bad news keeps coming. The unemployment rate climbed once again, from 3.2% in January to 3.4% in February this year.

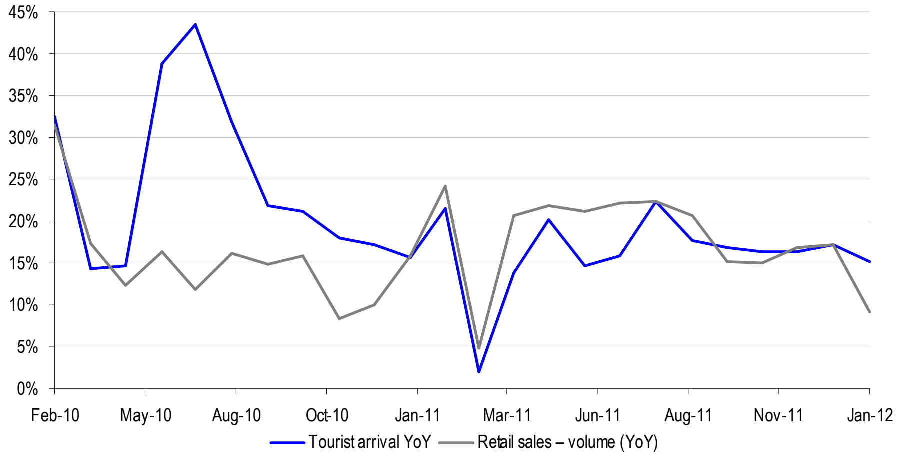
Looking further into 2Q12, we expect positive catalysts to include a recovery in property transactions, slower land sales, and policy easing on soft economic data and a declining inflation rate. For now, the global economic environment remains uncertain, with supply and demand within the trade sector liable to swing wildly up or down and with downsizing by financial companies putting office demand under pressure. These are the key obstacles to economic growth in Hong Kong.

Exports and imports contracted



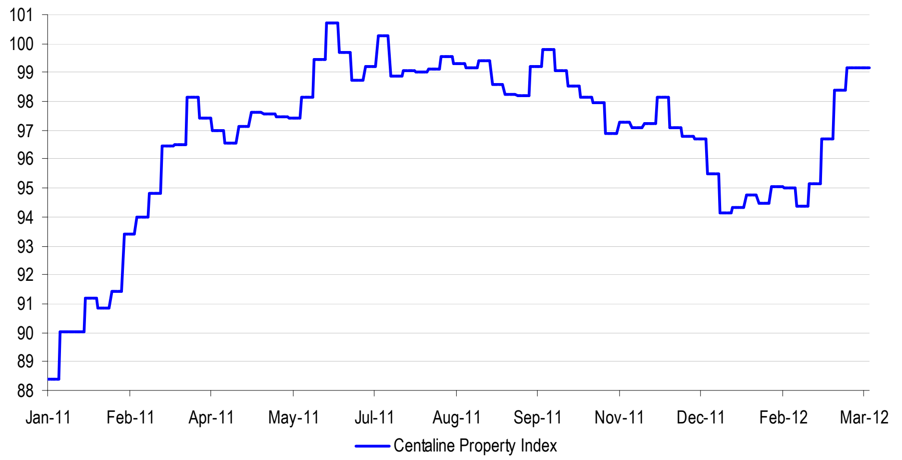
Source: Bloomberg, CCBIS

Private consumption and tourist arrivals dragged down on retail sales



Source: Bloomberg, CCBIS

Property market driven by commercial rental yields not as weak as expected



Source: Bloomberg, CCBIS

Appendices

Price difference between Shanghai A-share and B-share stocks

Company	Shanghai A-share	Price (RMB)	Market cap (RMB m)	Average daily volume 3-month (RMB m)	Shanghai B-share	Price (US$)	B-share (discount)/ premium to A-share (%)
China Textile Machinery	600610 CH	12.30	3,276.4	4.3	900906 CH	0.478	(75.3)
Tianjin Marine Shipping	600751 CH	6.80	2,460.5	6.8	900938 CH	0.295	(72.4)
Shanghai Diesel Engine	600841 CH	19.23	7,569.7	14.1	900920 CH	0.949	(68.6)
Shanghai Chlor-Alkali Chemical	600618 CH	10.23	8,982.1	84.6	900908 CH	0.512	(68.2)
Shanghai Erfangji	600604 CH	7.36	2,997.6	4.9	900902 CH	0.370	(68.0)
Zhonglu	600818 CH	14.01	3,370.7	24.1	900915 CH	0.711	(67.7)
SGSB Group	600843 CH	9.25	2,627.2	26.3	900924 CH	0.476	(67.3)
Jinshan Development & Construction	600679 CH	9.48	2,256.3	12.8	900916 CH	0.491	(67.0)
Shanghai Potevio	600680 CH	10.44	3,112.8	15.2	900930 CH	0.541	(67.0)
Danhua Chemical Technology	600844 CH	15.84	10,328.2	185.7	900921 CH	0.872	(65.0)
Double Coin Holdings	600623 CH	9.85	7,227.3	18.1	900909 CH	0.562	(63.7)
Shanghai Dingli Technology Development Group	600614 CH	12.18	5,970.5	213.9	900907 CH	0.696	(63.6)
Shanghai Dajiang (Group)	600695 CH	5.85	2,718.7	28.8	900919 CH	0.362	(60.6)
Jinan Qingqi Motorcycle	600698 CH	4.80	3,998.3	19.7	900946 CH	0.302	(60.0)
Shanghai Baosight Software	600845 CH	17.73	4,831.9	18.1	900926 CH	1.132	(59.4)
Shanghai Yaohua Pilkington Glass	600819 CH	8.04	4,985.9	14.0	900918 CH	0.520	(58.8)
Shanghai Sanmao Enterprise (Group)	600689 CH	9.41	1,621.2	11.8	900922 CH	0.615	(58.4)
Shanghai Haixin Group	600851 CH	6.71	6,279.5	103.6	900917 CH	0.449	(57.4)
Shanghai Wai Gaoqiao Free Trade Zone Development	600648 CH	9.35	8,377.8	9.6	900912 CH	0.635	(56.8)
Shanghai Automation Instrumentation	600848 CH	8.17	2,770.2	18.8	900928 CH	0.568	(55.8)
Shanghai Kai Kai Industrial	600272 CH	8.04	1,592.7	26.9	900943 CH	0.560	(55.7)
Shanghai Highly (Group)	600619 CH	7.70	3,417.9	26.3	900910 CH	0.539	(55.5)
Eastern Communications	600776 CH	6.18	6,726.4	45.3	900941 CH	0.433	(55.4)
Lao Feng Xiang	600612 CH	28.82	9,859.9	35.4	900905 CH	2.075	(54.2)
Shanghai Jinjiang International Hotels Development	600754 CH	17.12	8,963.7	14.6	900934 CH	1.330	(50.6)
Shanghai Lujiazui Finance & Trade Zone Development	600663 CH	11.86	19,108.3	37.0	900932 CH	0.935	(49.8)
Huangshan Tourism Development	600054 CH	15.96	6,329.2	28.4	900942 CH	1.319	(47.4)
SVA Electron	600602 CH	4.75	4,941.2	22.3	900901 CH	0.413	(44.7)
Shanghai Material Trading	600822 CH	6.22	2,822.5	17.8	900927 CH	0.570	(41.7)
Dazhong Transportation (Group)	600611 CH	5.27	7,140.3	25.0	900903 CH	0.490	(40.8)
Shanghi Jinqiao Export Processing Zone Development	600639 CH	7.24	5,932.0	26.2	900911 CH	0.687	(39.6)
Shanghai Zhenhua Port Machinery	600320 CH	4.64	17,473.5	43.4	900947 CH	0.453	(37.9)
Shanghai Nine Dragon	600555 CH	4.44	5,226.6	29.2	900955 CH	0.435	(37.7)
Shanghai Jin Jiang International Industrial Investment	600650 CH	7.92	3,914.0	9.0	900914 CH	0.809	(35.0)
Huadian Energy	600726 CH	2.66	4,860.5	7.1	900937 CH	0.286	(31.6)
Shanghai Mechanical & Electrical Industry	600835 CH	8.52	8,237.6	62.4	900925 CH	1.003	(25.1)
Shanghai Friendship Group	600827 CH	12.14	20,397.4	91.0	900923 CH	1.473	(22.8)
Huaxin Cement	600801 CH	14.75	12,786.3	126.6	900933 CH	1.853	(20.1)
Jinzhou Port	600190 CH	3.75	5,700.5	9.9	900952 CH	0.484	(17.9)
Hainan Airlines	600221 CH	4.60	18,945.6	92.8	900945 CH	0.703	(2.8)
Inner Mongolia Eerduosi Cashmere Products	600295 CH	–	10,233.8	69.3	900934 CH	1.330	–
Shanghai Lian Hua Fibre Corporation	600617 CH	–	1,482.7	1.9	900913 CH	–	–
Shanghai Wingsung	600613 CH	–	–	1.7	900904 CH	–	–

Data as of 12 April 2012

Source: Bloomberg

Price difference between Shenzhen A-share and B-share stocks

Company	Shenzhen A-share	Price (RMB)	Market cap (RMB m)	Average daily volume 3-month (RMB m)	Shenzhen B-share	Price (HK$)	B-share (discount)/ premium to A-share (%)
Shenzhen China Bicycle Company (Holdings)	000017 CH	3.23	1,258.7	14.0	200017 CH	1.39	(64.8)
Shijiazhuang Baoshi Electronic Glass	000413 CH	13.64	4,341.2	25.5	200413 CH	5.93	(64.4)
Shenzhen Victor Onward Textile Industrial	000018 CH	6.92	864.1	5.3	200018 CH	3.09	(63.4)
Hainan Dadonghai Tourism Centre (Holdings)	000613 CH	3.64	1,125.0	6.8	200613 CH	1.68	(62.2)
Guangdong Sunrise Holdings	000030 CH	12.50	3,308.5	78.0	200030 CH	6.17	(59.6)
China Fangda Group	000055 CH	5.40	3,020.0	33.5	200055 CH	2.74	(58.5)
Shenzhen Tellus Holding	000025 CH	7.06	1,448.7	5.8	200025 CH	3.73	(56.7)
Shenzhen Shenbao Industrial	000019 CH	11.15	2,632.9	23.6	200019 CH	5.98	(56.1)
Changchai	000570 CH	6.23	2,977.9	23.1	200570 CH	3.41	(55.2)
Shenzhen Nanshan Power	000037 CH	4.46	2,044.6	9.0	200037 CH	2.49	(54.3)
Shenzhen Special Economic Zone Real Estate (Group)	000029 CH	4.28	4,054.8	20.0	200029 CH	2.45	(53.1)
Konka Group	000016 CH	3.45	3,419.0	26.9	200016 CH	2.02	(52.1)
Bengang Steel Plates	000761 CH	4.64	13,587.5	7.7	200761 CH	2.75	(51.5)
Dalian Refrigeration	000530 CH	7.95	2,313.4	17.8	200530 CH	4.77	(50.9)
CSG Holding	000012 CH	9.39	15,827.1	399.2	200012 CH	5.65	(50.7)
Shenzhen Properties & Resources Development (Group)	000011 CH	7.92	4,446.9	70.6	200011 CH	4.78	(50.6)
Shenzhen Textile (Holdings)	000045 CH	8.93	2,780.7	52.0	200045 CH	5.41	(50.4)
Foshan Electrical and Lighting	000541 CH	9.92	8,587.8	69.0	200541 CH	6.10	(49.7)
China Merchants Property Development	000024 CH	22.00	34,144.4	180.4	200024 CH	13.90	(48.3)
Hainan Pearl River Holdings	000505 CH	3.36	1,327.8	12.7	200505 CH	2.13	(48.1)
BOE Technology Group	000725 CH	1.86	23,941.7	145.1	200725 CH	1.18	(48.1)
Chongqing Changan Automobile	000625 CH	4.81	20,490.2	70.5	200625 CH	3.28	(44.2)
Anhui Gujing Distillery	000596 CH	91.57	20,654.3	30.3	200596 CH	63.50	(43.2)
Guangdong Electric Power Development	000539 CH	5.05	12,672.7	21.6	200539 CH	3.53	(42.8)
Shenzhen International Enterprise	000056 CH	16.44	2,930.9	41.4	200056 CH	11.77	(41.4)
China International Marine Containers (Group)	000039 CH	13.68	28,690.6	234.4	200039 CH	10.20	(39.0)
Guangdong Provincial Expressway Development	000429 CH	3.32	3,726.0	7.8	200429 CH	2.51	(38.1)
Shandong Chenming Paper Holdings	000488 CH	5.02	8,464.3	49.1	200488 CH	3.81	(37.9)
Hefei Meiling	000521 CH	4.90	2,870.9	61.7	200521 CH	3.79	(36.7)
Shenzhen Accord Pharmaceutical	000028 CH	19.65	5,273.0	43.0	200028 CH	15.48	(35.5)
Jiangling Motors	000550 CH	22.24	16,590.6	23.9	200550 CH	18.07	(33.5)
Luthai Textile	000726 CH	8.39	7,255.6	66.0	200726 CH	6.97	(32.0)
Livzon Pharmaceutical Group	000513 CH	20.64	5,455.0	43.2	200513 CH	18.30	(27.4)
Yantai Changyu Pioneer Wine	000869 CH	93.18	44,821.1	90.2	200869 CH	85.08	(25.3)
Shenzhen Chiwan Wharf Holdings	000022 CH	10.36	6,226.3	15.0	200022 CH	9.65	(23.7)
Wuxi Little Swan	000418 CH	9.56	5,646.2	76.1	200418 CH	9.20	(21.2)
Chengde Dalu	200160 CH	1.34	946.5	1.0	200160 CH	1.34	(18.1)
Chongqing Jianshe Motorcycle	200054 CH	2.25	1,074.4	0.5	200054 CH	2.25	(18.1)
Foshan Huaxin Packaging	200986 CH	3.89	1,966.1	2.2	200986 CH	3.89	(18.1)
Guangdong Rieys	200168 CH	1.84	586.2	0.7	200168 CH	1.84	(18.1)
Hangzhou Steam Turbine	200771 CH	10.75	6,754.7	8.5	200771 CH	10.75	(18.1)
Nanjing Putian Telecommunications	200468 CH	3.18	683.7	0.8	200468 CH	3.18	(18.1)
Shandong Airlines	200152 CH	12.16	4,864.0	14.4	200152 CH	12.16	(18.1)
Shandong Zhonglu Oceanic Fisheries	200992 CH	3.53	939.2	2.0	200992 CH	3.53	(18.1)
Shenzhen Chiwan Petroleum Supply Base	200053 CH	8.03	1,851.7	0.8	200053 CH	8.03	(18.1)
Shenzhen Zhongheng Huafa	200020 CH	3.04	1,899.9	0.9	200020 CH	3.04	(18.1)
Tsann Kuen (China) Enterprise	200512 CH	1.23	1,368.2	1.9	200512 CH	1.23	(18.1)
WaFangDian Bearing Group	200706 CH	5.58	2,246.5	0.8	200706 CH	5.58	(18.1)
Wuxi Weifu High-technology	200581 CH	21.30	25,158.7	7.9	200581 CH	21.30	(18.1)
China Vanke	000002 CH	8.68	94,138.4	516.5	200002 CH	9.48	(10.6)
Shenzhen Fiyta Holdings	000026 CH	–	4,234.5	56.2	200026 CH	–	–
Hubei Sanonda	000553 CH	–	–	4.5	200553 CH	–	–

Data as of 12 April 2012

Source: Bloomberg

Price difference between H-share and A-share stocks

Company	A-share	Price (RMB)	Market cap (RMB m)	Average daily volume 3-month (RMB m)	H-share	Price (HK$)	H-share (discount)/ premium to A-share (%)
Luoyang Glass	600876 CH	6.48	1,963	21.2	1108 HK	1.69	(78.6)
Sinopac Yizheng Chemical Fibre	600871 CH	6.96	20,243	14.7	1033 HK	1.89	(77.8)
Nanjing Panda Electronics	600775 CH	6.49	3,034	11.4	553 HK	1.80	(77.3)
Shandong Xinhua Pharmaceutical	000756 CH	5.72	1,990	10.6	719 HK	1.91	(72.7)
Shenji Group Kunming Machine Tool	600806 CH	7.23	3,098	42.0	300 HK	2.42	(72.6)
Tianjin Capital Environmental Protection Group	600874 CH	5.58	6,613	41.9	1065 HK	1.98	(71.0)
Jingwei Textile Machinery	000666 CH	10.98	5,261	71.7	350 HK	4.20	(68.7)
Shandong Molong Petroleum Machinery	002490 CH	15.18	4,753	41.5	568 HK	6.17	(66.7)
Hisense Kelon Electrical Holdings	000921 CH	4.15	4,346	18.7	921 HK	1.70	(66.5)
Guangzhou Shipyard International	600685 CH	15.52	7,934	110.3	317 HK	6.80	(64.1)
Sinopec Shanghai Petrochemical	600688 CH	5.96	34,280	37.1	338 HK	2.78	(61.8)
Beijing North Star	601588 CH	2.94	8,669	22.1	588 HK	1.48	(58.8)
Datang International Power Generation	601991 CH	5.02	57,354	32.1	991 HK	2.67	(56.5)
Aluminum Corporation of China	601600 CH	6.83	77,242	136.0	2600 HK	3.69	(55.8)
Xinjiang Goldwind Science & Technology	002202 CH	7.65	18,549	158.7	2208 HK	4.34	(53.6)
Huadian Power International	600027 CH	3.03	18,247	26.7	1071 HK	1.78	(51.9)
China Eastern Airlines	600115 CH	3.78	36,249	88.3	670 HK	2.41	(47.8)
Metallurgical Corporation of China	601618 CH	2.60	46,251	89.2	1618 HK	1.73	(45.5)
China Oilfield Services	601808 CH	17.15	65,142	177.2	2883 HK	11.54	(44.9)
BYD Company Limited	002594 CH	31.40	62,818	137.8	1211 HK	21.45	(44.1)
Zijin Mining Group	601899 CH	4.28	82,215	391.3	2899 HK	2.99	(42.8)
Yanzhou Coal Mining	600188 CH	23.32	95,435	184.3	1171 HK	16.62	(41.7)
Shandong Chenming Paper Holdings	000488 CH	5.02	8,464	49.1	1812 HK	3.63	(40.8)
Jiangxi Copper	600362 CH	24.99	72,303	441.7	358 HK	18.16	(40.5)
Dalian Port (PDA)	601880 CH	2.68	10,738	21.2	2880 HK	2.00	(38.9)
Shanghai Electric Group	601727 CH	5.40	63,035	37.2	2727 HK	4.08	(38.1)
China Southern Airlines	600029 CH	4.67	40,914	216.6	1055 HK	3.58	(37.2)
Shenzhen Expressway	600548 CH	4.01	7,682	12.4	548 HK	3.19	(34.9)
Sichuan Expressway	601107 CH	3.78	10,383	20.8	107 HK	3.04	(34.2)
Huaneng Power International	600011 CH	5.23	67,348	51.3	902 HK	4.31	(32.5)
Air China	601111 CH	6.16	70,521	103.1	753 HK	5.19	(31.0)
BBMG Corporation	601992 CH	8.34	32,700	114.2	2009 HK	7.09	(30.4)
China Shipping Container Lines	601866 CH	3.12	32,874	67.7	2866 HK	2.67	(29.9)
China Shipping Development	600026 CH	6.08	18,309	33.1	1138 HK	5.22	(29.7)
Guangshen Railway	601333 CH	3.47	23,074	71.3	525 HK	2.98	(29.7)
Dongfang Electric	600875 CH	21.93	41,829	252.9	1072 HK	19.36	(27.7)
Anhui Expressway	600012 CH	4.66	7,132	17.0	995 HK	4.25	(25.3)
Maanshan Iron & Steel	600808 CH	2.51	18,255	34.8	323 HK	2.33	(24.0)
China Coal Energy	601898 CH	9.19	112,594	123.9	1898 HK	8.55	(23.8)
China COSCO Holdings	601919 CH	5.19	49,993	136.0	1919 HK	4.95	(21.9)
Shanghai Pharmaceuticals Holding	601607 CH	11.33	28,909	208.4	2607 HK	11.46	(17.2)
Bank of China	601988 CH	3.05	812,098	86.1	3988 HK	3.18	(14.6)
China CITIC Bank	601998 CH	4.38	194,924	92.6	998 HK	4.57	(14.6)
Great Wall Motor	601633 CH	13.72	39,990	99.0	2333 HK	14.82	(11.6)
PetroChina	601857 CH	9.85	1,780,493	171.2	857 HK	10.84	(9.9)
China Railway Group	601390 CH	2.56	53,485	71.7	390 HK	2.85	(8.9)
Zoomlion Heavy Industry	000157 CH	9.73	73,850	435.9	1157 HK	11.02	(7.3)
China Petroleum & Chemical	600028 CH	7.27	620,925	293.1	386 HK	8.27	(6.9)
Weichai Power	000338 CH	31.67	51,949	252.9	2338 HK	36.55	(5.5)
Industrial and Commercial Bank of China	601398 CH	4.36	1,500,197	221.9	1398 HK	5.05	(5.2)

(continued on next page)

Price difference between H-share and A-share stocks (continued from previous page)

Company	A-share	Price (RMB)	Market cap (RMB m)	Average daily volume 3-month (RMB m)	H-share	Price (HK$)	H-share (discount)/ premium to A-share (%)
China Life Insurance	601628 CH	17.23	480,439	263.7	2628 HK	20.15	(4.3)
China Minsheng Banking Corp.	600016 CH	6.39	179,400	776.9	1988 HK	7.48	(4.2)
ZTE Corporation	000063 CH	16.34	55,864	341.5	763 HK	19.46	(2.5)
Angang Steel	000898 CH	4.38	31,531	62.6	347 HK	5.22	(2.4)
China Pacific Insurance (Group)	601601 CH	20.21	172,380	371.0	2601 HK	24.15	(2.2)
China South Locomotive & Rolling Stock	601766 CH	4.45	61,268	141.8	1766 HK	5.39	(0.8)
Bank of Communications	601328 CH	4.72	291,209	264.4	3328 HK	5.78	0.2
Northeast Electric Development	000585 CH	2.65	1,788	0.0	42 HK	0.75	0.8
CITIC Securities	600030 CH	12.99	143,176	839.4	6030 HK	16.08	1.3
China Shenhua Energy	601088 CH	26.24	522,753	381.9	1088 HK	32.65	1.9
Agricultural Bank of China	601288 CH	2.68	871,864	242.3	1288 HK	3.36	2.6
Jiangsu Expressway	600377 CH	6.05	30,630	12.3	177 HK	7.61	3.0
China Construction Bank	601939 CH	4.76	1,227,711	162.7	939 HK	6.06	4.2
Tsingtao Brewery	600600 CH	34.69	47,739	75.5	168 HK	44.40	4.8
China Railway Construction Corporation	601186 CH	4.18	52,039	102.1	1186 HK	5.43	6.3
China Merchants Bank	600036 CH	12.01	262,425	654.8	3968 HK	15.84	8.0
Anhui Conch Cement	600585 CH	17.27	96,753	684.2	914 HK	26.25	24.4
Ping An Insurance (Group) Co. of China	601318 CH	39.07	338,090	918.7	2318 HK	59.50	24.7
Beiren Printing Machinery Holdings	600860 CH	–	1,723	8.7	187 HK	1.59	–
Guangzhou Pharmaceutical	600332 CH	–	8,551	29.1	874 HK	6.85	–
Chongqing Iron & Steel	601005 CH	–	–	3.5	1053 HK	1.38	–

Data as of 12 April 2012

Source: Bloomberg

Contact for analysts

Dr. Peter So
(852) 2532 6786
peterso@ccbintl.com
- Strategy/Autos

Dr. Banny Lam
(852) 2532 2578
bannylam@ccbintl.com
- Global Macroeconomics

Rocky Zhang
(852) 2533 2411
rockyzhang@ccbintl.com
- Economics

Stephanie Tong
(852) 2844 3602
stephanietong@ccbintl.com
- Global Macroeconomics

Contact for institutional sales team

Douglas Morin
Head of Institutional Sales
(852) 2532 6791
douglasmorin@ccbintl.com
- Institutional Sales (Hong Kong)

Donald Klip
(852) 2532 2573
donaldklip@ccbintl.com
- Institutional Sales (Hong Kong)

Janice Chia
(852) 2533 2459
janicechia@ccbintl.com
- Institutional Sales (Hong Kong)

Jonathan Page
(852) 2532 2572
jonathanpage@ccbintl.com
- Institutional Sales (Hong Kong)

Margaret Kao
(852) 2532 6109
margaretkao@ccbintl.com
- Institutional Sales (Hong Kong)

Mark Jolley
(852) 2532 6177
markjolley@ccbintl.com
- Institutional Sales (Hong Kong)

Xin Zhao
(852) 2844 3658
zhaox@ccbintl.com
- Institutional Sales (Hong Kong)

Yan Tsui
(852) 2532 6164
yantsui@ccbintl.com
- Institutional Sales (Hong Kong)

Daniel Widdicombe
(4420) 7038 6034
danielw@ccbintl.com
- Institutional Sales (United Kingdom)

Rong Yue
(44) 7877 330 441
yuerong@ccbintl.com
- Institutional Sales (United Kingdom)

Todd Hadden
(44) 7931 477 315
toddhadden@ccbintl.com
- Institutional Sales (United Kingdom)

Zhang Wei, Head of Greater China Institutional Sales
(852) 2533 2474
zhangwei@ccbintl.com
- Greater China Institutional Sales

Aaron Gu
(852) 2533 2475
guchuan@ccbintl.com
- Greater China Institutional Sales

Coco Chen
(852) 2533 2478
cocochen@ccbintl.com
- Greater China Institutional Sales

Grace Xu
(852) 2532 2550
gracexu@ccbintl.com
- Institutional Sales (Hong Kong)

Rating definitions

Outperform **(O)** – expected return 10% over the next twelve months

Neutral **(N)** – expected return between -10% to 10% over the next twelve months

Underperform **(U)** – expected return < -10% over the next twelve months

Analyst Certification:

The authors of this report, hereby declare that: (i) all of the views expressed in this report accurately reflect their personal views about any and all of the subject securities or issuers; and (ii) no part of any of their compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this report; and (iii) they receive no insider information/non-public price-sensitive information in relation to the subject securities or issuers which may influence the recommendations made by them. The authors of this report further confirm that (i) neither they nor their respective associate(s) (as defined in the Code of Conduct issued by the Hong Kong Securities and Futures Commission) has dealt in or traded in the securities covered in this research report within 30 calendar days prior to the date of issue of the report; (ii) neither they nor their respective associate(s) serves as an officer of any of the Hong Kong listed companies covered in this report; and (iii) neither they nor their respective associate(s) has any financial interests in the securities covered in this report.

Disclaimers:

This report is prepared by CCB International Securities Limited. CCB International Securities Limited is a wholly owned subsidiary of CCB International (Holdings) Limited ("CCBIH") and China Construction Bank Corporation ("CCB"). Information herein has been obtained from sources believed to be reliable but CCB International Securities Limited, its affiliates and/or subsidiaries (collectively "CCBIS") do not warrant its completeness or accuracy or appropriateness for any purpose or any person whatsoever. Opinions and estimates constitute our judgment as of the date of this material and are subject to change without notice. Investment involves risk and past performance is not indicative of future results. Information in this report is not intended to constitute or be construed as legal, financial, business, tax or any professional advice for any prospective investors and should not be relied upon in that regard. This report is for informational purposes only and should not be treated as an offer or solicitation for the purchase or sale of any products, investments, securities, trading strategies or financial instruments of any kind. Neither CCBIS nor any other persons accept any liability whatsoever for any loss arising from any use of this report or its contents or otherwise arising in connection therewith. Securities, financial instruments or strategies mentioned herein may not be suitable for all investors. The opinions and recommendations herein do not take into account prospective investors circumstances, objectives, or needs and are not intended as recommendations of particular securities, financial instruments or strategies to any prospective investors. The recipients of this report shall be solely responsible for making their own independent investigation of the business, financial condition and prospects of companies referred to in this report. Readers are cautioned that actual results may differ materially from those set forth in any forward-looking statements herein. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the forward-looking statements, opinions and expectations contained herein are based on fair and reasonable assumptions, CCBIS has not been able to verify independently such facts or assumptions and CCBIS shall not be liable for the accuracy, completeness or correctness thereof and no representation or warranty is made, express or implied, in this regard. The recipients must make their own assessments of the relevance, accuracy and adequacy of the information contained in this report and make such independent investigation as they may consider necessary or appropriate for such purpose. Recipients should seek independent legal, financial, business and/or tax advice if they have any doubt about the contents of this report and satisfy themselves prior to making any investment decision that such investment is in line with their own investment objectives and horizons.

The recipients should be aware that CCBIS may do business with the issuer(s) of the securities covered in this report or may hold interest in such securities for itself and/or on behalf of its clients from time to time. As a result, investors should be aware that CCBIS may have a conflict of interest that could affect the objectivity of this report and CCBIS will not assume any responsibility in respect thereof. Where applicable and required, any relationship CCBIS may have with the issuers(s) of the securities or interests in such stocks(s) will be disclosed in this section of the report. The information contained herein may differ or be contrary to opinions expressed by other associates of CCBIS or other members of the CCBIH group of companies.

CCBI group has an investment banking relationship with Bank of Communications Co., Ltd. (3328 HK), Boer Power Holdings Ltd. (1685 HK), CITIC Securities Co. Ltd. (6030 HK), China Pacific Insurance (Group) Co., Ltd. (2601 HK) and Ping An Insurance (Group) Co. of China Ltd. (2318 HK) within the past 12 months.

This report is for distribution only under such circumstances as may be permitted by applicable law. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. This report is not directed at you if CCBIS is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that CCBIS is permitted to provide research material concerning investments to you under relevant legislation and regulations. In particular, this report is only distributed to certain US Persons to whom CCBIS is permitted to distribute according to US securities laws, but cannot otherwise be distributed or transmitted, whether directly or indirectly, into the US or to any US person. This report also cannot be distributed or transmitted, whether directly or indirectly, into Japan and Canada and not to the general public in the People's Republic of China (for the purpose of this report, excluding Hong Kong, Macau and Taiwan).

Any unauthorized redistribution by any means to any persons, in whole or in part of this research report is strictly prohibited and CCBIS accepts no liability whatsoever for the actions of third parties in distributing this research report.

CCB International Securities Limited

34/F, Two Pacific Place, 88 Queensway, Admiralty, Hong Kong

Tel: (852) 2532 6100 / Fax: (852) 2537 0097