Second Quarter 2009

Equity Strategy
Pan-Asia

HSBC Global Research

Asia Insights Quarterly

The long climb back

- **Improving macro data and newsflow mean that equities could remain buoyant for a while longer**
- **But structural problems in the global economy have not gone away, so this is unlikely to turn into a sustainable bull market**
- **We recommend taking cyclical exposure but minimising other risks: we like Singapore, India, Taiwan and cyclical blue-chips**

Macro data and newsflow are likely to improve over the next few months. Economic indicators such as exports are showing the first signs of bottoming and lead indicators – notably the US manufacturing ISM – point to them improving further. Asian equities should continue to benefit from this. But, after a 24% rally in the past few weeks, some of this is already priced in. What may not be priced in yet is that analysts' and economists' forecasts for 2009, and analysts' stock recommendations, are very cautious. The momentum of these is likely to turn up – which could give a further boost to stocks.

It is too early to say whether this is just a bear market rally, or whether stocks have found a bottom. It doesn't matter much. Nasty bear markets in history have often seen 50% rallies; the first leg-up after a bear market ends is typically about the same. This suggests that for now, there is more upside than downside risk for equities. But it is true that the upside is easier to foresee than the downside. Too many problems lurk out there to make us confident that this is the start of a new sustainable bull market. The most likely scenario is that the economy will double-dip and equities will face a rough period again later in the year. We continue to believe that Asian equities will end this year ±10% from their level at the beginning – in the first three months of the year they were flat.

How to play this as an investor? Our recommendation (not so different to last quarter) is to take some exposure to the cyclical pick-up while minimising other risks. We increase slightly our weightings in cyclical sectors: we are overweight industrials and energy and raise consumer discretionary, IT and financials to neutral. We go underweight expensive defensive sectors like utilities, healthcare and telecoms. Most of all, we recommend a portfolio of cyclical blue-chip stocks – although, admittedly, it is harder to choose these after the recent run-up. We also suggest some names for a higher-beta punchy portfolio.

Among markets, we would take our cyclical exposure in Taiwan (which we raise to overweight) and Singapore. We prefer these to Japan and Korea: Singapore is structurally safer; Taiwan has the advantage of improving cross-Strait relations. We lower China to neutral after its 50% rise since October and because we see no further short-term catalysts. We prefer India (we stay overweight), where growth will pick up later this year and which will offer an attractive investment opportunity once the general election is out of the way.

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HSBC strategy recommendations

Market recommendations

Market	HSBC recommendation	Last quarter	Rel Perf 3 mnth	End-2009 target	Current index	Change (%)
Japan	Neutral	Neutral	-5.9%	850	813	4.6%
Australia	Neutral	Neutral	6.6%	3,800	3,580	6.1%
China	Neutral	Over	8.1%	45	42	8.2%
Korea	Under	Under	6.0%	1,000	1,222	-18.1%
Taiwan	Over	Neutral	17.9%	6,000	5,242	14.5%
Hong Kong	Neutral	Neutral	7.4%	16,000	13,910	15.0%
India	Over	Over	-1.6%	11,000	9,471	16.1%
Singapore	Over	Over	-3.4%	1,900	1,706	11.3%
Malaysia	Under	Under	1.6%	800	878	-8.9%
Indonesia	Neutral	Neutral	7.8%	1,400	1,436	-2.5%
Thailand	Under	Under	0.9%	400	438	-8.7%
Philippines	Under	Under	5.3%	1,700	1,918	-11.4%
New Zealand	Under	Under	4.0%	n.a	1,812	n/a
Pakistan	Under	Under	2.7%	n/a	6,617	n/a
Vietnam	No weight	No weight	-7.4%	300	271	10.9%

Source: HSBC; Note: Current Index and Rel perf as of 24 Mar 2009

Sector recommendations

Sector	HSBC recommendation	Last quarter	Rel Perf 3 mnth	Markets overweight	Markets underweight
Financials	Neutral	Under	-2.3%	TW, IN	AU, JP, KR
Industrials	Over	Over	-0.7%	JP	
IT	Neutral	Under	10.0%	TW	
Consumer discretionary	Neutral	Under	9.1%		IN, TW
Materials	Under	Neutral	9.7%		AU, IN, TW
Telecoms	Under	Neutral	-11.1%	KR	CH, IN, TW
Consumer staples	Neutral	Neutral	-11.8%	CH	
Utilities	Under	Neutral	-11.2%	CH	HK, JP
Energy	Over	Over	12.6%	CH, IN	KR, TW
Healthcare	Under	Neutral	-15.5%		IN, JP

Source: HSBC; Note: Current Index and Rel perf as of 24 Mar 2009

Asia Super 10

Code	Company	Country/region	Sector	HSBC rating	Upside to target price (%)	Price (local, 03/31/09)	Market cap (USDm)
2409 TT	AU Optronics	Taiwan	Industrials	Overweight (V)	34.8	28.1 (TWD)	7,035
3988 HK	Bank Of China Ltd	China	Financials	Overweight (V)	16.7	2.6 (HKD)	113,837
1800 HK	China Communications Cons	China	Industrials	Overweight (V)	38.1	8.5 (HKD)	16,509
2881 TT	Fubon FHC	Taiwan	Financials	Overweight (V)	15.4	20.5 (TWD)	4,900
RIL IN	Reliance Industries	India	Energy	Overweight (V)	7.6	1524.8 (INR)	47,298
2727 HK	Shanghai Electric Group	China	Industrials	Overweight (V)	65.9	2.2 (HKD)	6,207
386 HK	Sinopec	Hong Kong	Energy	Overweight (V)	21.0	5 (HKD)	100,383
SBIN IN	State Bank of India	India	Financials	Overweight (V)	25.6	1067.1 (INR)	13,353
19 HK	Swire Pacific	Hong Kong	Industrials	Overweight (V)	19.9	51.7 (HKD)	6,041
763 HK	ZTE Corporation	Hong Kong	IT	Overweight (V)	14.1	31.6 (HKD)	913

Source: HSBC

We acknowledge the assistance of Devendra Joshi, an associate in our Bangalore office, in compiling the data for this report.

HSBC

Contents

Investment strategy

- Cyclical indicators and newsflow will generally improve over coming months
- But too many problems still lurk out there to make this the start of a new bull market
- For now, there is more upside than downside risk for equities, but the upside risk is easier to foresee – and therefore partly priced in

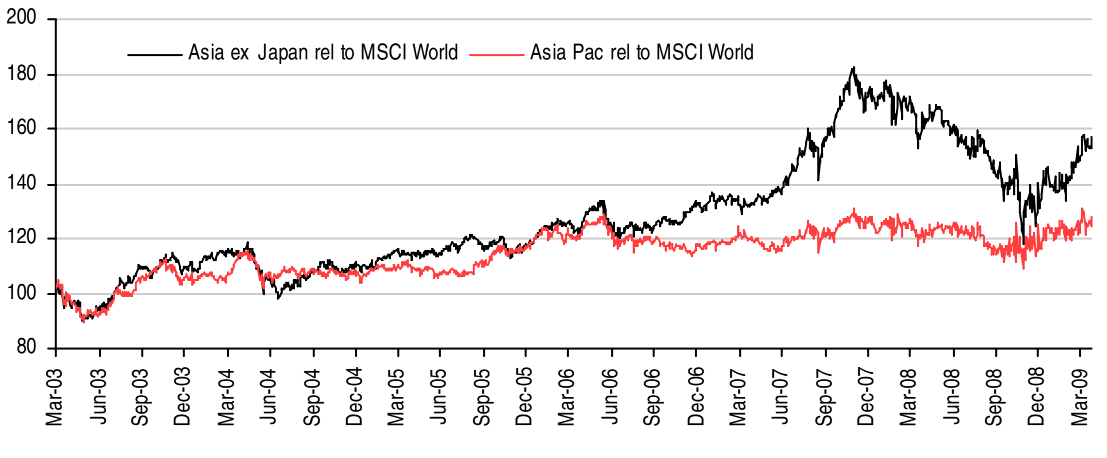
The long climb back

MSCI Asia ex Japan ended Q1 up just 0.2% from the start of the year. Our prediction in the Q1 Quarterly that this year would be characterised by sharp rallies, as macro data improved, and sharp corrections triggered by nasty surprises (last quarter these were the disappointing US fiscal stimulus and worries about eastern Europe) seems about right so far.

Over the next quarter or two, the chances are that there will be more positive macro news than nasty surprises. Economic data fell off a cliff late last year. Readers will be aware of the numbers, but it is hard to exaggerate just how bad they were: at the low point Japanese output, for example, was shrinking 38% y-o-y, Taiwanese exports falling 44%, and Singapore's GDP contracted at an annualised rate of 16.4% in Q4. These data can hardly get any worse and, as we show below, there are already early signs of them improving.

But having fallen off a cliff, the climb back up will take time and effort. There will be many

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



Source: HSBC, Bloomberg

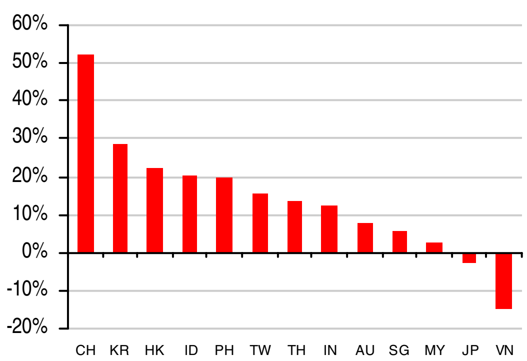
dangerous potholes and precipices along the way. The US banking system is far from fixed. Over the next year or two, we would not be surprised to see some big companies file for bankruptcy and defaults by sovereign borrowers. The global recovery is likely to falter, since US consumer spending will probably be weak for some time as households repair balance sheets. The side-effects of massive fiscal stimulus and quantitative monetary easing are hard to forecast (but could include nasties such as inflation and uncomfortably high government debt).

In our view, these impediments mean we are unlikely to enter a new bull market soon – in the sense of a sustained multi-year run-up in equity prices. The market is more likely to be characterised by sharp ups and downs for some time to come.

Bear bottoms

That does not, however, preclude the possibility of some sharp run-ups in share prices.

2. Change in MSCI indexes since 28 October 2008

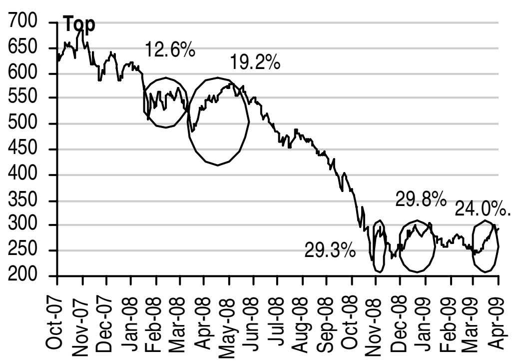


Source: HSBC, Bloomberg

The bottom for Asian markets, so far at least, was 27 October last year (although a few – plus the US – made new lows again in March). Many markets are already significantly above their October lows: China, in particular, is up 52% since then, and Korea, Hong Kong, Indonesia and the Philippines have all risen by 20% or more (Chart 2).

Even if the bear market is not over and markets go on to make new lows, investors should always keep in mind that rallies during bear markets can be big. Already in the latest bear market, which began in October 2007, there have been five rallies of 10% or more – the biggest almost 30% (see Chart 3). In historically large market falls, like the most recent one, the bear market rallies can be even bigger than that: in the midst of the Asia Financial Crisis, for example, there was a 50% rally (in early 1998), the US in the early 1930s saw a rally of 48%, and during Japan's decade-long bear market in the 1990s there were rallies of 54%, 44% and 78%.

3. Rallies in the current bear market

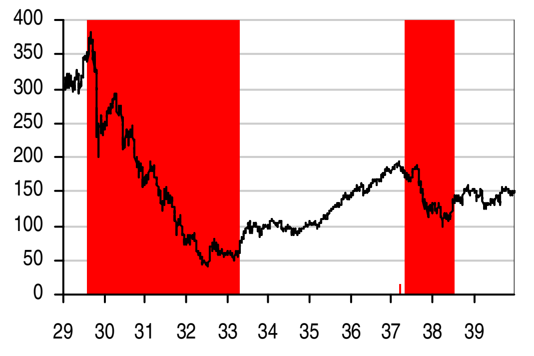


Source: HSBC, Bloomberg

Moreover, once the bear market ends, the rebound can often be dramatic. In the US in the 1930s, the Dow Jones Industrials (DJIA) rose by as much as 371% in the four years after it bottomed in July 1932. Once Sweden sorted out its banking crisis in September 1992, the OMX index rose by 877% to the end of the decade. The post-Asia Crisis rebound was not quite so long-lived, but MSCI Asia ex Japan rose by a healthy 155% in the 17 months after bottoming in September 1998.

But that can be hard for investors to catch onto. Often, most of the upside comes in the initial phase of the rebound. Markets rapidly discount the fact that the worst is over and that stocks have got over-sold but, after bouncing sharply, take a while to consolidate while waiting to see whether the recovery is sustainable. In the 1930s, for instance, the DJIA rose by 68% in the four months after President Roosevelt was inaugurated and introduced sweeping reforms (including closing all the banks for a week). But it then moved sideways for over a year before taking off again in spring 1935. That rally kept going until the economy went into a new recession in 1937 (see Chart 4 – the red areas are recessions).

4. DJIA 1929-1940

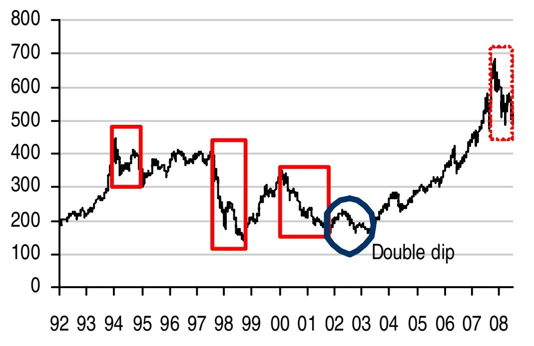


Source: HSBC, Bloomberg

The risk, though, is of a double-dip or, at worst, a long period when markets move within a trading range.

Double-dips are quite common. After the TMT bubble burst in 2000, for example (Chart 5), Asian stocks fell until September 2001, then rallied 53% but fell back and almost made a new low in March 2003 (the US did go down to a new low).

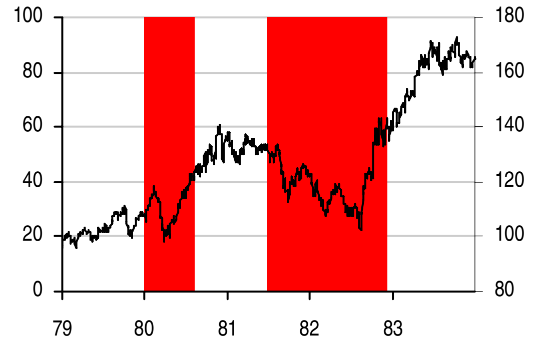
5. Bear markets in MSCI Asia ex Japan 1992-now



Source: HSBC, Bloomberg

The risk of a second recession closely following the first cannot be ruled out either. This happened in Japan in the 1990s. It also happened in the US in the early 1980s (see Chart 6), where the 1980 recession ended in July (according to official National Bureau of Economic Research dating) but the economy entered recession again in July 1981. The stock market responded accordingly.

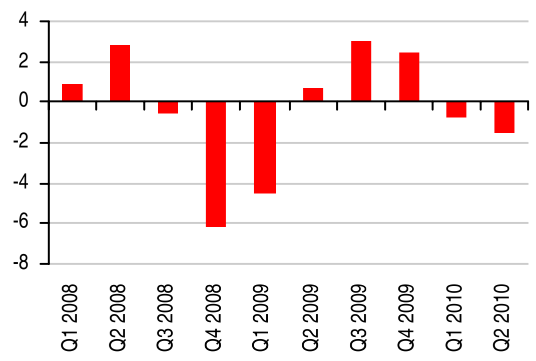
6. S&P500 1979-1983



Source: HSBC, Bloomberg

The forecasts of HSBC's economics team imply something like just such a double-dip. They look for quarterly GDP growth to turn positive in Q2 2009, but then go back into negative territory in Q1 and Q2 2010 (Chart 7). For 2010 as a whole, HSBC forecasts only 0.5% GDP growth (after a contraction of 3.0% in 2009). Our economists believe that capex and exports will continue to fall for some time, even though they expect public spending will grow and

7. HSBC forecasts for US real GDP growth, q-o-q ann



Source: HSBC

consumption and housing will pick up soon.

Investors need to position for the upside

All of this presents some difficult questions for fund managers. Can they afford to be out of the market, or very defensively positioned, when rebounds can be that big? But if there is a rebound, how long will it last and how quickly should they take profits? How can they position their portfolio for the cyclical upswing (albeit possibly short-lived) while protecting it from the downside risks? What happens if the global financial system continues to deteriorate, triggering a 1930s-style Great Depression?

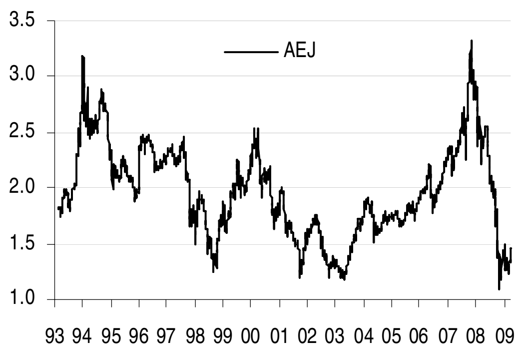
But there is an asymmetry here: fund managers positioned for a depression will underperform and probably lose their jobs if there is a strong recovery – but most of them will lose their jobs anyway if indeed there is a depression. The same is probably true of this year too when, with most investors still cautious, being correctly positioned for the rallies will drive a fund manager's outperformance more than being conservative into the downturns.

Two fundamental factors, in particular, suggest to us that the upside for stocks is probably bigger than the downside: valuations and investors' positions.

With earnings particularly hard to forecast at the moment, the price/earnings ratio is not a useful indicator in our view. Often at the start of a bull market PE is high since it is based on trough earnings. (For what it is worth, 12-month forward PE for MSCI Asia ex Japan is 13.2x – a little lower than the long-run average of 14.5x – pushed up by such markets as Taiwan, where earnings have collapsed.)

Price/book ratio is likely to be more useful in these circumstances. As shown in Chart 8, PB for Asia ex Japan has risen from an historic low of 1.1x last October to 1.5x – because of the market's rise and some erosion of book value.

8. Prospective price/book, MSCI Asia ex Japan



Source: HSBC, IBES, Datastream

But that is still very low by historical standards. Over the long-term (using data going back to the early 1990s) PB in Asia has averaged 2.0x – since 2001 it averaged 1.9x. In other words, the market could rise *another* 30% before getting back to mid-cycle average valuations. Most markets in Asia (Table 9) trade on PBs well below their historical averages (the only exceptions are Korea, China and the Philippines – one of the reasons we are underweight Korea and the Philippines, and have cut our rating for China to neutral in this Quarterly).

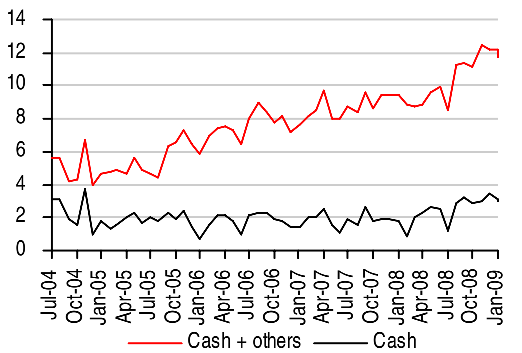
9. PB versus historical average for MSCI indexes

	Current PB	Long-run average
Indonesia	2.6	2.9
India	1.9	3.0
China	1.8	2.0
Philippines	1.7	1.9
Australia	1.6	2.5
Malaysia	1.4	2.2
Taiwan	1.4	2.5
Korea	1.2	1.2
Thailand	1.1	2.1
Singapore	1.1	1.8
Japan	1.0	1.7
Hong Kong	0.9	1.6
Asia Pacific	1.2	1.9
Asia ex Japan	1.5	2.0

Source: HSBC, IBES, Datastream

Second, we believe that most investors are still positioned for the bear market. Anecdotally, we find few fund managers who believe that the recent rally will last; most take a gloomy view of global fundamentals. (In late March, investors were forced to scramble to raise their exposure.)

10. Asia ex Japan mutual funds holdings of cash and others



Source: Emerging Portfolio Fund Research

Finding hard evidence to prove this is difficult, but we would point to the weightings of Asia ex Japan mutual funds globally. We have been puzzled for some time that their cash holdings had not risen substantially in the downturn – they rose only from about 1% or so in mid-2007 to 3% in January (see Chart 10, which uses data from Emerging Portfolio Fund Research). The answer seems to be that most emerging markets funds have rules that limit cash holdings, and they have made their funds more defensive by raising their holding of "others" (which rose from less than 3% in 2004 to over 9% recently).

Data and newsflow to improve

In our view, all this says that investors will need to be more than usually nimble this year and be prepared to trade in and out of rallies and corrections. With transparency limited, having a clear view on the next one to two quarters will be crucial.

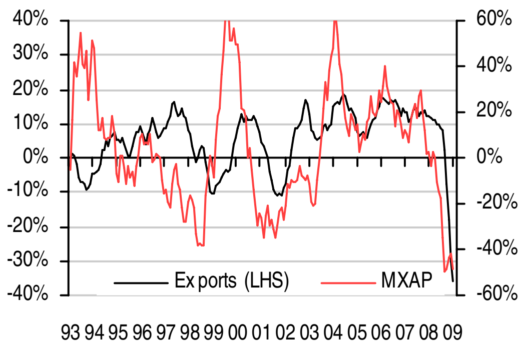
And our view is that data and newsflow are likely to be generally positive over the next few months.

This could mean that this rally lasts longer than investors currently believe (or that there are more rallies).

Exports

One key is exports. These held up surprisingly well until about September last year (when an MSCI-weighted three-month moving average of Asian exports was still growing 8%). By February, this had collapsed to -36% (Chart 11), with Japanese exports down 43% and Taiwanese ones down 39%. And the true picture is worse than this since these data are three-month moving averages and, additionally, February was flattered because Lunar New Year was in January this year.

11. Asian export growth vs. MSCI Asia Pacific



Source: HSBC, Bloomberg

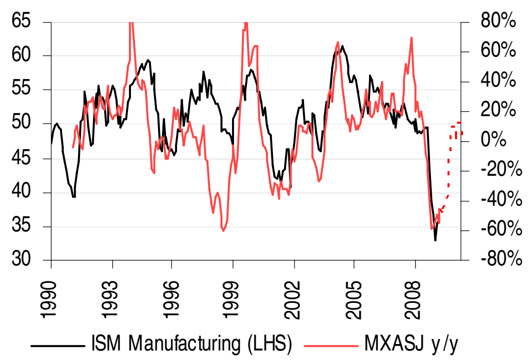
Intuitively, it seems unlikely that the decline can get much bigger. And, indeed, there are the first tentative signs that the numbers are starting to improve: Korea's export decline was at its worst in January, for example; seasonally adjusted, our economists believe the numbers have improved in both the past two months.

As Chart 11 shows, this is important for equities, since the MSCI Asia Pacific index does have a good correlation – particularly at turning points – with export growth. Equities (for example in 1998 or 2001) anticipated a rebound in exports just a month or two ahead of this happening.

Lead indicators

Leading indicators are starting to point in the same direction. We have long argued that the US manufacturing ISM gives one of the clearest messages about the direction of Asian equities. The close correlation is apparent in Chart 12 (the correlation coefficient over the past 10 years has been 0.75).

12. US manufacturing ISM vs MSCI Asia ex Japan

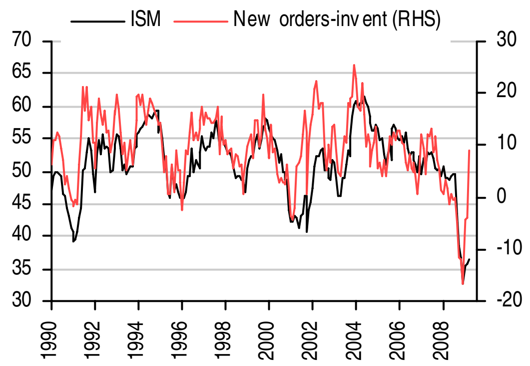


Source: HSBC, Bloomberg

The March ISM, announced on April 1, was somewhat disappointing, rising only to 36.3, not far above the cycle low of 32.9 last December. What is encouraging, though, is that the new orders series rose sharply, while inventories fell. New orders minus inventories has in the past given a very reliable guide to where the headline ISM will move over the coming two or three months (Chart 13). This chart suggests that the ISM could get back to 50 quite quickly. And, given the (frequently misunderstood) way in which the ISM and other similar PMIs are calculated, that would not be so surprising. The question asked to companies in the survey is not whether their business is doing well or poorly, but how well it is doing *compared to the previous month*. Business conditions can be very poor, but if they are not quite as terrible as last month, the ISM will rise above 50.

The implications for equities are clear. If the ISM were to rebound to 50 within the next few months,

13. Headline ISM vs. ISM new orders-inventories

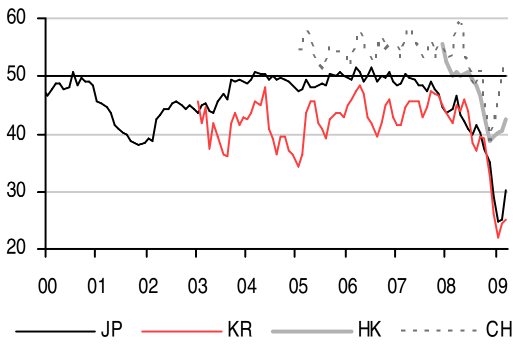


Source: HSBC, Bloomberg

that would be positive for both Asian exports (for which the ISM is also a good lead indicator) and for stocks. The calculation for stocks is not quite so simple since what Chart 12 shows is the correlation between the ISM and the *y-o-y change* in the MSCI index. How the latter will move over the next 12 months, assuming the index stays at its current level, is shown by the dotted red line. This line will, of course, move up to 0% by next March if the index doesn't change. What an ISM of 50 in a few months' time implies, therefore, is that stock prices could get back to the 0% y-o-y change level more quickly than this. This would happen by September, for example, if the index were to rise by 30% over the next six months.

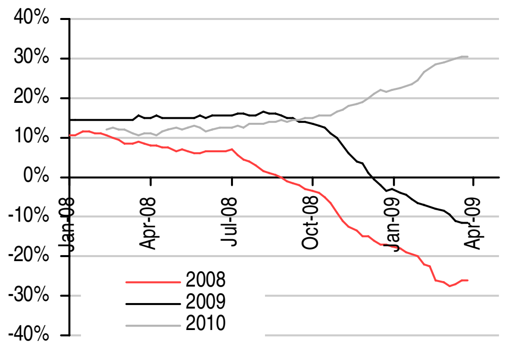
Asian leading indicators are starting to turn up, too. All four major markets that publish reliable monthly business sentiment indicators saw an improvement in the most recent data-point, with China's PMI going back over 50 (Chart 14). Even in Japan, while the March Tankan survey hit a record low, the monthly Shoko Chukin index of small business sentiment (which we have found a better lead indicator for equities than the quarterly Tankan, which tends to lag) improved in both February and March. Most of these indexes do not have much history. But those that do – the Shoko Chukin, for example – have provided a consistently useful indicator of markets bottoming.

14. Selected business sentiment indicators



Source: HSBC, Bloomberg

15. Consensus forecasts for y-o-y EPS growth, Asia ex Japan



Source: HSBC, IBES, Datastream

So far, so good. But with markets having rallied so strongly in March, a good deal of this is already understood and discounted. Can there be much in the way of further upside surprises?

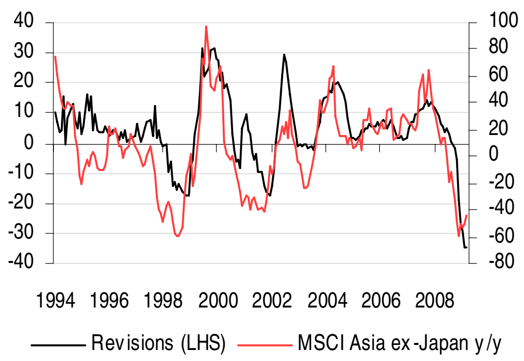
Earnings

One place these could come from is analysts' earnings forecasts and recommendations.

Analysts have continued to cut forecasts, but the first signs are coming through that revision momentum is bottoming. For example, with most announcements for 2008 now in (only a few Hong Kong-listed and Taiwan companies will not report until April), results turned out to be not *quite* as bad as analysts estimated - down 26% y-o-y, rather than the -28% they expected in early March (Chart 15). Chinese companies, for example, saw a 3% decline in EPS, where analysts had foreseen -5%. The 2009 forecast, however, continues to be revised down: analysts currently expect earnings to decline by 11.4% this year, compared to a forecast of -3.2% at the beginning of January. Those numbers have been revised down further in the past couple of months as most companies have given out weak guidance at the time of their results announcements.

However, once the results season is over – and especially if export and production data show signs of stabilising – there will be few reasons for analysts to revise down further for a while. That should allow the momentum of earnings forecasts to bottom. And earnings momentum (which we define as the change over the past six months in the 12 months forward forecast) has a close correlation with stock markets (Chart 16).

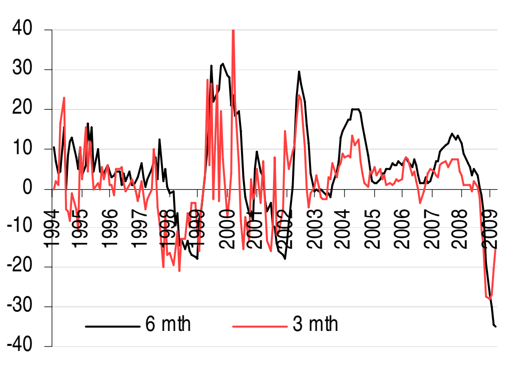
16. Momentum of EPS forecasts vs MSCI Asia ex Japan



Source: HSBC, IBES, Datastream

In March, earnings momentum was -35% – by far the worst it has even been. Purely mathematically, this will inevitably improve over coming months, not least since for next year analysts forecast (an unrealistically optimistic, in our view) 31% growth in EPS. As this number starts to have a bigger weight in the 12-month forward number, it will rise. The change in momentum is already clear from the three-month momentum indicator, which has improved over the past two months (Chart 17) and which is often a useful guide to where the six-month indicator will move (but is too volatile to be useful in predicting market movements).

17. 3-month and 6-month earnings momentum

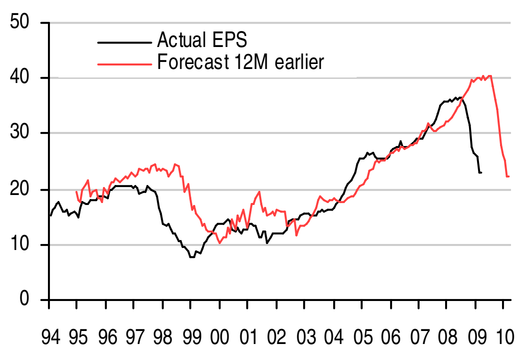


Source: HSBC, IBES, Datastream

Could analysts even start to revise up their forecasts? For 2009, it is not impossible. In some markets, they have priced in quite pessimistic scenarios. In Taiwan, for example, they forecast a 59% fall in EPS (after -54% last year), including an aggregate loss in the technology sector. Analysts also forecast -23% for Singapore, -18% for Hong Kong and -17% for Malaysia (all of which saw double digit declines in earnings last year, too).

It is worth remembering that analysts are typically still cutting their forecasts several months after earnings have in fact bottomed. Chart 18 shows the actual EPS for MSCI Asia ex Japan EPS compared to analysts' 12-month forward consensus forecasts a year earlier. Obviously, they are far too optimistic during earnings recessions, such as 1998 or 2008. But it is clear that they are also too pessimistic (albeit not quite so dramatically) when earnings rebound, as in 2000 or 2003.

18. Analysts' forecasts for MSCI Asia ex Japan vs outcome

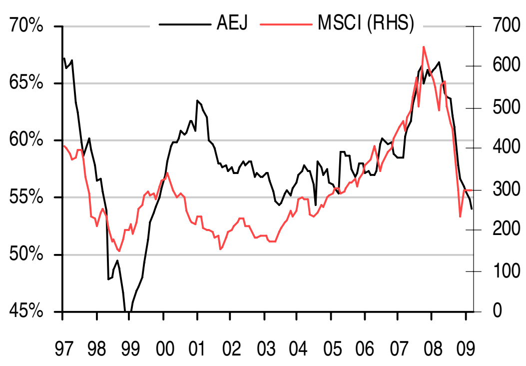


Source: HSBC, IBES, Datastream

Analysts' recommendations

An indicator we have been watching since the bear market started is the analysts' rating ratio (the ratio of Buy recommendations to total recommendations). This is a useful contrarian indicator – we argued until recently that analysts still had too many Buy ratings for one to think that the end of the bear market was close.

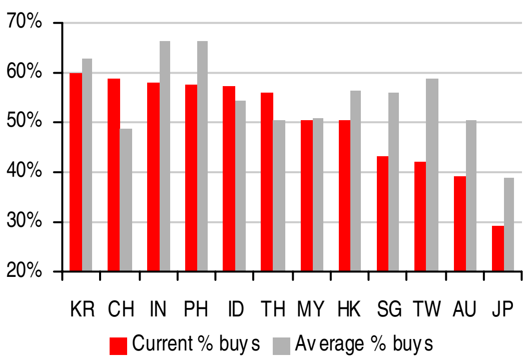
19. Analysts' Buy rating ratio vs MSCI Asia ex Japan



Source: HSBC, Bloomberg

But the percentage of Buys has come down quite sharply in the past few months (Chart 19) reaching 54% – below the level it got to in the 2000-3 bear market. Only in China, Indonesia and Thailand is the current Buy ratio higher than the average percentage of Buys over the past 12 years (Chart 20).

20. Analyst Buy rating ratio by market



Source: HSBC, Bloomberg

In the past, particularly after the Asia Crisis, the number of Buys fell sharply just after the market started to rebound (to an extent, the same thing happened in 2002). What happened, we believe, is that analysts, who had been pricing stocks on ultra-conservative measures (such as break-up value or historic trough price/book), found that the stocks had hit their target and so downgraded to neutral.

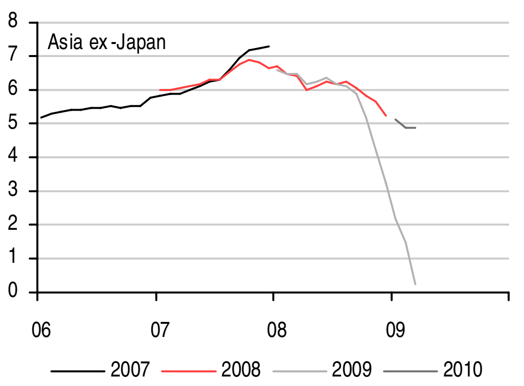
We are seeing the same phenomenon now, not least in HSBC's own research team. But the next stage is for analysts to become slightly more aggressive in their target multiples or valuation methodology. Already we have noticed some of our analysts switching from trough valuation-based targets to, for example, historic average PEs. Ratings were raised very rapidly in 1999, when this happened.

Why this is important for the market is that, as analysts upgrade stocks (and fund managers make the same change in valuation thinking) it gives further excuses for investors to buy. We would not be surprised to see the Buy ratio bottom out over the next couple of months.

Economic forecasts

Economists are likely to behave similarly. They too have slashed forecasts over the past few months. The 2009 real GDP growth forecast for Asia ex Japan (weighted by the country weights in the MSCI index) has fallen to just 0.2%, down from 3.2% in December and 5.9% as recently as September (Chart 21).

21. Consensus forecast for real GDP growth (MSCI weighted)



Source: Consensus Economics

Can they cut any further? It seems unlikely. The individual country forecasts in Table 22 show that economists now expect GDP to contract by 3% or more in Japan, Taiwan, Singapore, Hong Kong and Korea. Only perhaps China (7.0%), India (5.2%) and some smaller countries such as the Philippines (1.9%) would seem at risk of further forecast cuts if conditions continue to deteriorate dramatically. Most of the bad news for this year at least is well priced in (although there could be some disappointment over the strong recovery forecast for next year in many countries).

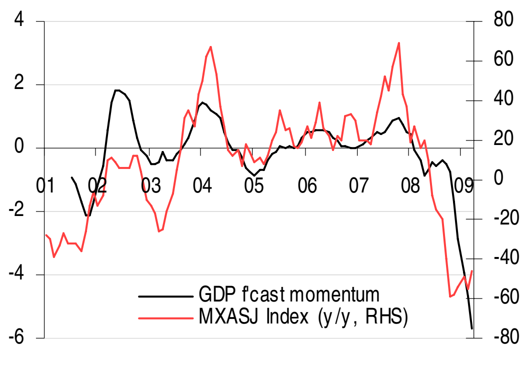
22. Consensus real GDP growth forecasts (%, y-o-y)

	2008	2009	Change v 6m	2010
China	9.3	7.0	-2.1	8.3
India*	6.9	5.2	-2.4	7.8
Indonesia	6.1	3.4	-2.2	4.7
Philippines	4.2	1.9	-2.9	3.6
Australia	2.3	-0.3	-2.9	1.7
Malaysia	5.3	-0.7	-5.8	3.6
Thailand	4.3	-1.6	-6.2	3.2
Korea	4.0	-3.0	-7.3	3.5
Hong Kong	2.9	-3.4	-7.6	2.4
Singapore	2.0	-4.7	-9.3	3.2
Taiwan	2.1	-4.9	-9.3	2.9
Japan	0.4	-5.8	-6.7	0.7
Asia Pac	**2.3**	**-2.9**	**-5.8**	**2.5**
Asia ex-Japan	**5.2**	**0.2**	**-5.6**	**4.9**

Source: Consensus Economics (* calendarised)

That means that – like analysts' earnings forecasts – economists' forecast momentum will almost certainly bottom out. The momentum indicator (also measured as the change over the past six months in the 12-month forward forecast), shown in Chart 23, is as bad as it has ever been (although we do not have data going back to the Asia Crisis period). As the 2010 forecast becomes a greater part of the 12-month forward, this will start to rise. As the chart shows, this indicator has been quite a good guide to stock market movements, especially at the turning points.

23. GDP forecast momentum vs MSCI Asia ex Japan



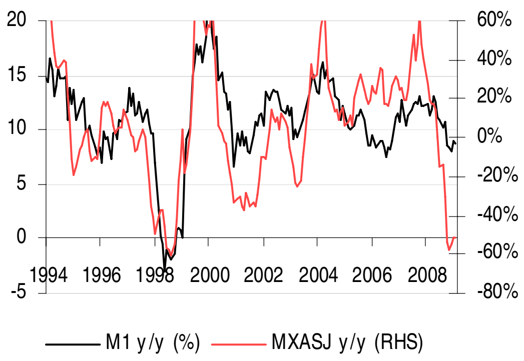
Source: HSBC, Consensus Economics, Bloomberg

Newsflow

As well as the hard data (or softer data, such as consensus forecasts), investors need to think about whether newsflow over the next few months will generally beat expectations or spring nasty surprises. Our guess would be that it will mainly produce positive surprises – for a few months at least. Examples:

- **US banks**. We won't add much to the mass of words written on this subject. But our feeling is that expectations are low. Few investors expect the US government to take strong action on the banks, for example nationalising them. Most are sceptical about the stress-tests, results of which will be known in the next few weeks. That may be right. But President Obama's tougher stance on auto-makers could presage that he will take decisive action. That would be an upside surprise.

24. Asia ex Japan average M1 growth vs MSCI index

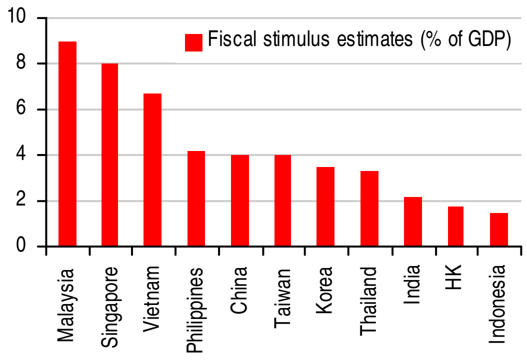


Source: HSBC, Bloomberg

- **Quantitative easing**. One key reason for markets to bounce in the past few weeks was the Federal Reserve, Bank of England (and, to a degree, Bank of Japan) announcing they would move to quantitative easing. Asian central banks have not taken rates to zero yet, but monetary policy is certainly ultra-easy. Remember that, in most circumstances, stock markets have a close relationship with money supply growth (especially M1). In Asia ex Japan, the correlation since 1996 is 0.70 (Chart 24). In the US, M1 has already started to accelerate; in the past three months average y-o-y growth has been 15%, compared to zero mid last year. In Asia, too, as the chart above shows, M1 appears to have bottomed, most notably in China, where it jumped to 11% y-o-y in February up from 7% in January. One warning: when Japan tried (a half-hearted) quantitative easing in the 1990s but the monetary transmission mechanism broke down, the correlation between stocks and M1 vanished.

- The effects of **fiscal policy** start to show through. This has already happened in China where, for example, cement production has accelerated to 11% y-o-y in January/February versus less than 1% at the end of last year. It should happen modestly in the US later this year – one reason why we expect a pick-up in US growth in H2 (see Chart 7 above). The unprecedented fiscal stimulus in Asia (as much as 8% or 9% of GDP in some countries – see Chart 25 for our economists' estimates) will surely start to kick in over the coming quarters too.

25. Estimated fiscal stimulus as percentage of GDP



Source: HSBC estimates

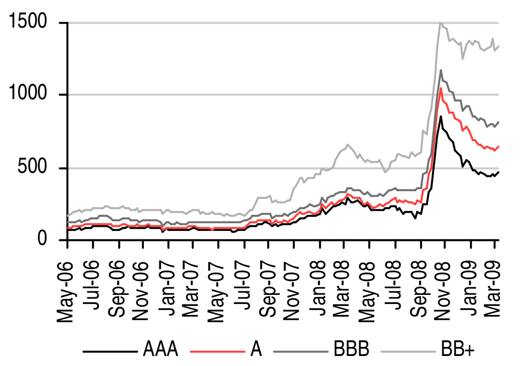
What can go wrong next?

Before we get too carried away by the excitement of a possible rebound over the next few months, we should also remember that the way back up the cliff will be slippery and steep.

While the likely positive trends over the next few months are fairly easy to see, the negative surprises are much harder to forecast. Where will the shocks come from? Almost by definition, we do not know.

The fact that most indicators of risk in Asia remain at elevated levels should tell us something. Corporate bond spreads, for example, have fallen from the peak levels they reached last September after Lehman Brothers collapsed (Chart 26). But they are still well above the level of early September 2008: the spread on A-rated bonds, for example, is currently about 650bp, compared to only 350bp late last summer.

26. Asian corporate USD bond spreads

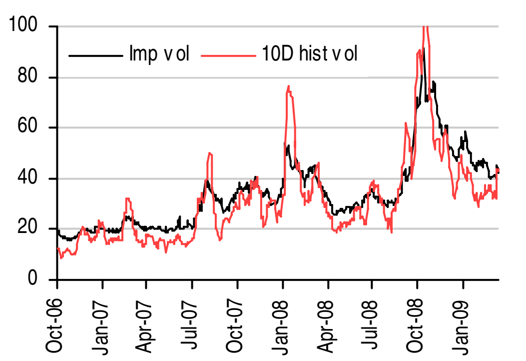


Source: HSBC, Bloomberg

Other risk measures tell a similar story: Indonesia credit default swaps for example are currently around 570bp, lower than a peak of 1200bp in October, but well above the 260bp level they traded at in August last year.

The same is true of stock market volatility. As shown in Chart 27, implied volatility of the six markets in Asia with index options contracts has fallen back from the extreme levels (annualised volatility of over 90%) it reached in Q4 last year but, at around 40-45% still implies a significantly higher risk than at almost any time during the past decade.

27. Average historic and implied volatility of 6 Asian markets



Source: HSBC, Bloomberg

We do not need to go into detail on what could go wrong. Our economists have done that in their various Quarterlies. Suffice it to say that, from a macro-economic point of view, these include deflation, inflation, rising unemployment, further falls in US house prices, long-term weakness in US consumer spending, further cuts in private-sector capex, sell-offs in government bond markets, rising protectionism, currency disorder, sovereign defaults and a sharp rise in corporate bankruptcies. The slowdown has been so sharp and deep that we have no roadmap to show us exactly what could be the knock-on effects.

Most importantly, the global banking system is far from fixed. The lesson from previous nasty bear markets (1907 and the 1930s in the US, or 1992 in Sweden or, as a contrary example, Japan in the 1990s) is that the worst is over only when the problems in the banking system are solved. The chances of the US achieving that are perhaps higher than the market currently believes, but they do not seem that high.

The rosy scenario also assumes that there will be no policy gaffes. The Great Depression dragged on longer than necessary because of a series of mistakes: the Fed raised interest rates much too early, and many countries stuck too stubbornly to the gold standard. Policymakers will not make the same mistakes again – but they could make other equally serious ones.

We are also concerned that while analysts' and economists' forecasts for this year are now appropriately cautious, they are assuming a strong rebound next year – something that our economists think unlikely. As mentioned above, analysts see 31% growth in Asia ex Japan corporate earnings in 2010; economists forecast 4.9% GDP growth. There is definitely room for downside surprises there when markets begin to focus on the 2010 outlook, sometime around Q3.

Think back to the charts of nasty bear markets we showed earlier in this piece. The typical pattern was of a sharp initial rebound, with markets rising perhaps 50% over a period of a few months, followed by a lengthy period of moving sideways. That ended only when the market either took off and entered a new full-blown bull market or, alternatively, double-dipped.

As things stand now, the most likely scenario for markets is that the rally continues for a while but that stocks struggle in the second half of this year as it becomes clear that the problems have not disappeared and that economic growth will be anaemic for some time to come.

Market recommendations

- We want to take some exposure to a cyclical pick-up while minimising other risks
- That means overweights on Taiwan, Singapore, and India, and underweights on Korea and most of Asean
- We lower China to neutral as an economic rebound is priced in

Cyclical exposure…

…at a reasonable risk

With markets likely to be characterised by sharp up- and downswings, we continue to recommend a balanced approach to market allocation. If we believed straightforwardly that a new bull market had started, driven by an end to the global economic slowdown, we would be overweight Korea, Taiwan and Japan. If we believed the world was headed for further problems, we would be maximising cash and long the most defensive markets in Asia, such as Malaysia.

The truth is somewhere in the middle. We want to have some cyclical exposure, because of the likelihood that economic data will improve over the summer. But, while we want to take some exposure to equities and to cyclicality, we also want to avoid unnecessary risk.

We have again used a scorecard to help us think through which markets optimally give us this mix (see Table 2 overleaf). We have made two changes to the format for the scorecard we used in the first quarter:

- We replaced the category "Sensitivity to US/global growth" with "Exposure to cyclical rebound". Rather than avoiding markets that are

1. Market recommendations

Market	HSBC recommendation	Last quarter	Rel Perf 3 mnth	End-2009 target	Current index	Change (%)
Japan	Neutral	Neutral	-5.9%	850	813	4.6%
Australia	Neutral	Neutral	6.6%	3,800	3,580	6.1%
China	Neutral	Over	8.1%	45	42	8.2%
Korea	Under	Under	6.0%	1,000	1,222	-18.1%
Taiwan	Over	Neutral	17.9%	6,000	5,242	14.5%
Hong Kong	Neutral	Neutral	7.4%	16,000	13,910	15.0%
India	Over	Over	-1.6%	11,000	9,471	16.1%
Singapore	Over	Over	-3.4%	1,900	1,706	11.3%
Malaysia	Under	Under	1.6%	800	878	-8.9%
Indonesia	Neutral	Neutral	7.8%	1,400	1,436	-2.5%
Thailand	Under	Under	0.9%	400	438	-8.7%
Philippines	Under	Under	5.3%	1,700	1,918	-11.4%
New Zealand	Under	Under	4.0%	n.a	1,812	n/a
Pakistan	Under	Under	2.7%	n/a	6,617	n/a
Vietnam	No weight	No weight	-7.4%	300	271	10.9%

Source: HSBC Note: Index data and Rel Perf as of 24 March 2009

2. Market scorecard

	Monetary & fiscal policy	Earnings risk	Politics/ social stability	Exposure to cyclical rebound	Valuation	Structural worries	Long-term story	TOTAL	Rank	Weight
Weighting	*10%*	*20%*	*10%*	*20%*	*10%*	*20%*	*10%*	*100%*		
SG	2	0	1	2	2	-1	0	0.7	1	O
TW	2	-1	1	3	1	-1	1	0.7	2	O
IN	1	0	-1	1	1	-1	3	0.4	3	O
CH	2	-1	-1	1	0	-1	3	0.2	4	N
HK	0	0	1	1	1	-1	0	0.2	5	N
JP	1	-1	-1	3	1	-2	-2	-0.1	6	N
AU	1	-2	1	1	1	-1	0	-0.1	7	N
ID	1	-1	0	0	0	-1	1	-0.2	8	N
MY	2	-1	-2	0	0	-1	1	-0.3	9	U
TH	1	-2	-2	1	2	-1	-1	-0.4	10	U
KR	2	-3	0	3	0	-3	0	-0.4	11	U
PH	1	-3	-2	1	0	-2	-1	-1.0	12	U
VN	2	-3	0	1	0	-2	1	-0.5	12	

Source: HSBC

most sensitive to exports and to the global cycle, we want to increase our weighting modestly here since these markets are likely to outperform if, as we believe, exports and industrial production data and analysts' forecasts bottom out over the next one to two quarters.

- We tweaked the weightings assigned to each factor. We cut the weighting for "monetary and fiscal policy" to 10% from 20%. Since all countries have announced big stimulus packages and rate cuts, this is unlikely to be as much of a focus. We also cut the weighting for "politics and social stability" to 10% from 20% because, as economies start to stabilise, social unrest or the risk of governments falling should become less of an issue. By contrast, we raised the weight of "earnings risk" to 20% from 10% because we see a turning point coming in analysts' forecasts, with some countries, where analysts have cut too far, seeing upward revisions and vice versa. We introduce the "exposure to cyclical rebound" factor at a 20% weighting.

As previously, this table is meant to be purely a tool to aid the thinking process rather than a quantitative model (we have experimented with these in the past, but not found meaningful results). We score each factor from +3 to -3, based on our economists' and analysts' views and on our own judgement.

Currently, what we would ideally like to see in a market is (1) strong fiscal and monetary stimulus, (2) earnings that are likely to beat analysts' expectations, (3) no risk of political or social upheaval, (4) likelihood that the economy and earnings will pick up relative to other markets in the region as the global cycle rebounds, (5) attractive stock market valuations, (6) no structural worries in, for example, the banking system, balance-of-payments, or government fiscal position, and (7) an enticing long-term growth story.

Obviously, no market has a perfect combination. But in the current environment we are looking for those that have the best mix. Essentially, that means wanting to be overweight either 1) markets that are cyclical but without too much structural and political risk and that are reasonably valued, or 2) markets that are relatively "safe", in terms of having strong economies and limited structural risks, but that should give decent upside if the economy shows renewed signs of life.

Of our three overweight markets this quarter, **Taiwan** fits in the first category, **Singapore** the second. **India** is more of a China laggard - we think the stability of its economic growth has been overlooked by markets (which preferred to focus on election risk and the inability to implement a punchy fiscal stimulus). While Chinese stocks have risen 52% since the market bottom last October, Indian stocks are up only 9%.

Our biggest underweights are markets which present too much structural risk: investors do not need to take this unnecessary risk in an environment where most markets are reasonably valued and when relatively safer markets offer good cyclical exposure. Underweights include **Thailand**, **Philippines** and **Korea**.

We have cut **China** to neutral because, after its recent run-up, it no longer looks so attractive: it is hard to see where positive catalysts will come from over the next one or two quarters. We remain at least neutral on the big developed markets, **Japan, Australia** and **Hong Kong**.

The only changes we have made this quarter are to lower China, and to raise Taiwan to overweight from neutral.

Detailed explanation of our views on the major markets (Japan, China/Hong Kong, Korea, Taiwan and India) are in the "Main markets" section of this report. Brief comments on our choices follow below.

Overweights

- Pessimism on **India** seems to us overdone. The economy is likely to rebound starting from the July-September quarter, with CY2009 real GDP growth coming in at 6.2%. We expect earnings growth of 5-10% this year, too, whereas the consensus has already been cut to 4%. We find most investors (including Indians) to be pessimistic because of the fiscal position and the general election to be held in April and May. While the first worry is justified, we believe the risk of an anti-market government emerging is very low. An attractive prospective PE of 11.4x suggests India could rebound once the election is out of the way.
- **Singapore** offers an attractive combination of cyclical exposure and structural safety. The economy has been hurt badly by the global slowdown – unsurprising given that exports are 97% of GDP. HSBC forecasts that GDP will contract by 7% this year. This negative news has pushed down the stock market (which has fallen 48% over the past year) as investor sentiment soured. Despite this, earnings have proved remarkably resilient, falling only 12% last year. Due to the market's fall, valuations on many measures look the cheapest in Asia, with PE of 11.4x (despite an over-pessimistic consensus forecast that EPS will fall by 23% this year) and price to book (PB) of 1.1x. As a developed country with a high proportion of listed blue-chip stocks, Singapore should weather the storm comparatively well. This balance of risk/reward, in our view, merits an overweight.
- **Taiwan** is our favourite market for taking cyclical exposure. We raise our weighting to overweight from neutral (having taken it up from underweight in January). The economy has suffered disproportionately from the global slowdown, with exports in January falling 44% y-o-y and, on our forecasts, GDP likely to shrink 6.2% this year. But Taiwan is likely to benefit disproportionately as numbers bottom out, too. Forecasts have overshot: the analysts' consensus, for example, looks for a 59% fall in earnings this year (including an aggregate loss for the IT sector). With IT rush orders starting to pick up, there is a good chance that forecasts will start to be revised up a little in coming months. Moreover, Taiwan has fewer structural concerns than other equally cyclical markets. The banking sector is relatively sound and able to cope with the likely rise in NPLs. Companies' gearing is low. FX reserves, at

USD294bn, are particularly large for the size of the economy. To top all this, we expect to see further progress in cross-Strait relations in the coming months, particularly liberalisation of banking and inward investment.

Neutral

- **China**. It is hard to see where catalysts will come from to push up Chinese stocks – which have risen by 53% since last October – further. The latest economic data, particularly bank lending and fixed asset investment, is already showing that the government stimulus is working. After the rise, MSCI China trades on 11.1x earnings – not expensive, but already pricing in a swift economic recovery. We see further downside risk for earnings until Q4. Moreover, China has become a strong consensus overweight among fund managers over the past few months. Accordingly, we have cut from overweight to neutral, and are likely to wait until there are clear signs of an earnings recovery before becoming more positive.

- **Hong Kong**, as a developed market with attractive valuations (PB, at 0.9x, is the lowest in Asia), merits at least a neutral weighting. It will be helped by continued robust economic growth in China and the generally conservative nature of its large listed companies. But we would not go further than neutral. We forecast that property prices – closely linked with stock prices – will fall 20-30% this year. The high dependence on exports means that employment, and hence consumption, will be weak.

- **Australia** has not behaved like the defensive relative to Asia that it usually is. Worries about the health of the banking system and uncertainty about earnings in the resources sector are likely to continue to weigh on the stock market. Our view is that the next bull market (whenever it comes) is highly unlikely to be led by commodities, and so Australia probably has less beta on the upside this time. That said, this is a cheap market now: prospective PE at 12.2x is well below the post-2001 average of 14.4x. While the economy is not in great shape, it is more robust than some, with GDP unlikely to see negative growth this year (we forecast 0%). For investors using an Asia-Pacific benchmark we recommend a neutral weighting in Australia.

- **Japan**, like Korea and Taiwan, is tempting as a market to increase exposure to, since the economic data can hardly get any worse – industrial production, for instance, has fallen 38% y-o-y. Moreover, valuations look cheap, with PB at 1.0x. However, the continuing political impasse (which looks increasingly unlikely to be broken by the general election later this year), growing risks in the corporate and banking sectors, and the chances of the yen weakening should temper investors' enthusiasm. We can recommend no more than a benchmark-equal weighting.

- **Indonesia** stays neutral. In its favour, GDP growth is likely to be the third highest in Asia this year. The legislative elections in April and presidential election in July look likely to proceed smoothly, with President Susilo Bambang Yudhoyono the favourite to be returned to office. This should remind investors just how far Indonesia has progressed over the past few years. The economy and stock market are also relatively uncorrelated with global trends. On the negative side, the market has already performed well in the past few months, with PB rising to 2.5x (the highest in the region). Earnings are also somewhat linked to global commodity prices and could fall more than analysts' forecast of a 7% decline this year.

Underweights

- **Korea.** Like Japan and Taiwan, Korea would seem to offer attractions for investors who believe cyclical indicators will start to turn up over the coming months. But we believe there are more structural risks in Korea than in the other two markets. Analysts' earnings forecasts are more optimistic (flat y-o-y, versus -59% for Taiwan, for example), valuations not noticeably cheap with PE at 12.4x, bank NPLs are likely to rise and Korean borrowers are having to pay a premium to finance their overseas borrowing. There are less risky ways of obtaining cyclical exposure.

- We can see the attractions of taking a position in **Thailand.** After more than five years of political uncertainty, the current government of Abhisit Vejjajiva is showing signs that it might last. And, after years of poor performance, the Thai market is cheap, with prospective PE of 8.4x and PB of 1.1x. Now investment in Thai equities might make sense. But investors should realise, too, that risk is high. The economy does have a high dependency on global sectors such as car parts. After years of political wrangling, the long-term future remains uncertain. The health of the king is a concern. We stay underweight.

- **Malaysia** is the clearest example of an expensive defensive. Its defensiveness showed through last year, when it was the best performing market in Asia. This year it has – true to form – missed out during market rallies. It looks somewhat expensive too, with prospective PE of 12.7x not much below its post-2001 average. In addition, the political situation could destabilise after the arrival of Najib Razak as Prime Minister this month. Malaysia is not a bad place to hide for investors who believe the worst of the bear market is not over; for others, it should be an underweight, in our view.

- **Philippines** has the attraction that its economy and market are relatively uncorrelated with global trends. It is also true that government finances and the banking system are healthier than a few years ago. But we find this too risky a market to overweight in the current environment. Remittances have been the only thing keeping the economy going in recent years, but remittances are no longer growing and we forecast -20% y-o-y for 2009. With PE at 11.1x (based on a rather optimistic consensus forecast of 7% EPS growth this year), valuations are not especially attractive. And political instability is likely to remain a focus in the run-up to the presidential election in May 2010.

Non-benchmark

- **Vietnam** was the worst-performing market in Asia in Q1 in dollar terms. EPS for listed stocks fell 30% in 2008 as companies wrote off losses from property and stock market investment. In the absence of consensus forecasts, and with the economy slowing rapidly, there is little transparency about this year's earnings. Assuming EPS will be flat y-o-y this year, 12-month forward PE is 10.8x – unattractive for a market this risky. We think the Vietnamese market will continue to struggle this year and that there are more attractive markets in Asia which investors would be advised to enter first. Adventurous investors might, however, want to dip their toes back into the water on a long-term basis to buy some reasonably valued companies that stuck to their core business and avoided diversifying into real estate and finance.

Sector recommendations/ investment themes

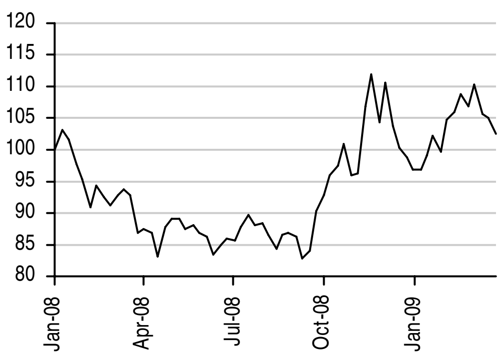
- Cyclical data will pick up over coming months; risk will stay high
- Best way to play this: cyclical blue-chips
- We slightly raise exposure to cyclical sectors versus defensives

Stick to quality cyclicals

We see little need to make dramatic changes from the investment themes we proposed in Q1. Then, we advocated switching out of expensive defensive sectors into quality blue-chips including cyclicals.

A portfolio built along those lines would have done well. In Q1 defensives underperformed – even though the overall market moved only sideways. The worst-performing sectors in Asia ex Japan were healthcare (-16%), telecoms (-9%) and consumer staples (-6%). The best-performing were cyclicals: IT +16%, consumer durables +9% and materials +7%. Our blue-chip index (defined as the 25 stocks with the lowest net debt/equity ratio from among the 50 largest-market-cap stocks in MSCI Asia ex Japan) outperformed the market by 4.2% in Q1, continuing an outperformance that began in September (see Chart 2).

2. Blue chip index relative to MSCI Asia ex Japan



Source: HSBC, Bloomberg, Datastream

Since we expect markets to continue to be characterised by bouts of excitement over the prospects of a cyclical recovery, followed by periods of risk-avoidance as the next problems surface, we

1. Sector recommendations

Sector	HSBC recommendation	Last quarter	Rel Perf 3 month	Markets overweight	Markets underweight
Financials	Neutral	Under	-2.3%	TW, IN	AU, JP, KR
Industrials	Over	Over	-0.7%	JP	
IT	Neutral	Under	10.0%	TW	
Consumer discretionary	Neutral	Under	9.1%		IN, TW
Materials	Under	Neutral	9.7%		AU, IN, TW
Telecoms	Under	Neutral	-11.1%	KR	CH, IN, TW
Consumer staples	Neutral	Neutral	-11.8%	CH	
Utilities	Under	Neutral	-11.2%	CH	HK, JP
Energy	Over	Over	12.6%	CH, IN	KR, TW
Healthcare	Under	Neutral	-15.5%		IN, JP

Source: HSBC; Rel Perf as of 24 Mar 2009

3. Asia Super 10

Code	Company	Country/region	Sector	HSBC rating	Upside to target price (%)	Price (local, 03/31/09)	Market cap (USDm)
2409 TT	AU Optronics	Taiwan	Industrials	Overweight (V)	34.8	28.1 (TWD)	7,035
3988 HK	Bank Of China Ltd	China	Financials	Overweight (V)	16.7	2.6 (HKD)	113,837
1800 HK	China Communications Cons	China	Industrials	Overweight (V)	38.1	8.5 (HKD)	16,509
2881 TT	Fubon FHC	Taiwan	Financials	Overweight (V)	15.4	20.5 (TWD)	4,900
RIL IN	Reliance Industries	India	Energy	Overweight (V)	7.6	1524.8 (INR)	47,298
2727 HK	Shanghai Electric Group	China	Industrials	Overweight (V)	65.9	2.2 (HKD)	6,207
386 HK	Sinopec	Hong Kong	Energy	Overweight (V)	21.0	5 (HKD)	100,383
SBIN IN	State Bank of India	India	Financials	Overweight (V)	25.6	1067.1 (INR)	13,353
19 HK	Swire Pacific	Hong Kong	Industrials	Overweight (V)	19.9	51.7 (HKD)	6,041
763 HK	ZTE Corporation	Hong Kong	IT	Overweight (V)	14.1	31.6 (HKD)	913

Source: HSBC

4. Punchy portfolio

Code	Company	Country/region	Sector	HSBC rating	Upside to target price (%)	Price (local, 03/31/09)	Market cap (USDm)
606 HK	China Agri-Industries Hol	Hong Kong	Consumer Staples	Overweight (V)	49.1	3.7 (HKD)	1,711
3983 HK	China BlueChemicals	China	Materials	Overweight (V)	33.3	4.2 (HKD)	2,515
2891 TT	Chinatrust FHC	Taiwan	Financials	Overweight (V)	37.9	12.4 (TWD)	3,327
966 HK	CIIH	Hong Kong	Financials	Overweight (V)	60.5	12.5 (HKD)	2,286
3481 TT	Innolux Display Corp	Taiwan	IT	Overweight (V)	30.1	33.1 (TWD)	3,044
323 HK	Maanshan Iron & Steel	Hong Kong	Materials	Overweight (V)	20.9	2.7 (HKD)	4,144
2343 HK	Pacific Basin Shipping	Hong Kong	Industrials	Overweight (V)	53.0	3.5 (HKD)	796
PNB IN	Punjab National Bank	India	Financials	Overweight (V)	17.9	411.5 (INR)	2,557
2325 TT	Siliconware Precision	Taiwan	IT	Overweight (V)	14.8	35.7 (TWD)	3,319
598 HK	Sinotrans	Hong Kong	Industrials	Overweight (V)	50.0	1.2 (HKD)	655

Source: HSBC

still recommend taking some cyclical exposure, while avoiding the excess risk that comes with buying small caps, high-beta stocks or companies with weak balance sheets. These will undoubtedly do well when a full-blown bull market begins (our blue-chip index underperformed, for example, in 2003-4), but we do not see this happening yet.

But which ones?

While we are happy to stick to this theme, executing it is getting harder. Many of the blue-chip cyclicals have already performed remarkably well. For example, with this report we are removing from our list of Asia's Super 10 stocks (Table 3) a number of names which have either reached our target price or where our analysts have downgraded the stocks as valuations got pricier: ICBC (1398 HK, Overweight (V), HKD4.03), Infosys (INFO IN, Overweight (V), INR1324), Sun Hung Kai Properties (16 HK, Overweight (V), HKD69.40) and TSMC (2330 TT, Neutral (V), TWD51.40).

Partly this is because of a typical market-bottom phenomenon among analysts (and not just HSBC's). For the past few months, they have been pricing stocks off trough valuations (using as reference, for example, the PB low from 1998 or 2001). They have also become very conservative in forecasting earnings given the lack of transparency. When the market has a 20-30% rally, this takes many stocks evaluated in this way up to their target price. Analysts' natural reaction is to downgrade. But once analysts gain more confidence about the robustness of the earnings recovery or about normalisation of market conditions, they will start to price stocks off mid-cycle valuations and raise earnings forecasts, albeit modestly.

The rules of our portfolios are that we can include only stocks covered by HSBC on which our analysts have an Overweight rating. With lots of downgrades to Neutral recently, this universe has dwindled. We suspect that it will grow again in coming weeks. We are expecting, therefore, to be shuffling the names around as new blue-chip Overweights emerge.

For now, we stick – as far as we can – in the Super 10 to large-cap stocks with quality managements, healthy balance sheets and dominant positions in their industries that give us some exposure to the cycle. Although we have cut four stocks from our most recently published list (those mentioned above), we are happy to stick to AU Optronics, Reliance, Shanghai Electric, Sinopec, Swire, and ZTE – all of which we believe still to have potential upside.

We have added four stocks: Bank of China (to replace ICBC), Fubon (the best-quality financial in Taiwan, where we have an overweight on the banks sector), State Bank of India (since we move to overweight on Indian banks), and China Communications Construction (which we see as the soundest of the China infrastructure plays).

A full explanation of why we like each of the companies in our Super 10, together with valuation and risks, is in the Top Stock Picks section at the end of this report.

This is not intended to be a short-term theme. We believe that this sort of Nifty-50 approach could be a winner over a number of years – as it was in previous periods of protracted market uncertainty, such as the US in the 1960s (the original Nifty 50) or Japan in the 1990s.

Punchy portfolio

When the market does rally sharply, as it did in March, we think it will be the higher-beta, punchier names that will outperform. Investors with a little more appetite for risk might like to consider putting a portion of their portfolios in some higher-risk/higher-return stocks to cover those rallies.

Last quarter we recommended a barbell approach, with 70-80% of the portfolio in blue-chips and 20-30% in stocks whose prices were 60-70% below their peak, but where the company had a decent business and would likely survive the downturn.

These stocks are no longer so cheap, so we are shifting the focus of this higher-risk portfolio to smaller-cap stocks, deep-value names and higher-beta cyclicals. We include four stocks from last quarter's list of 60-70% off-peak stocks (China Agri-Industries, Pacific Basin Shipping, Maanshan Iron & Steel, and Sinotrans). All three remain cheap – the first three have moved largely sideways during the past three months, and Sinotrans has fallen a further 20%. (Stocks we removed from last quarter: Bank of China (upgraded to the Super 10), Canara Bank (CBK IN, Neutral (V) INR165.70), CESC (CESC IN, Overweight (V), INR211) and Kingboard Chemical (148 HK, Overweight (V)), HKD15.90)).

We have added China BlueChemicals (as a fertiliser company, a play on Chinese rural demand), Chinatrust (a higher-beta way of taking a view that Taiwan banks are oversold), CIIH (the best-run of the Chinese insurance companies), Innolux (a mid-cap panel maker), Punjab National Bank (a cheaply valued Indian bank with a strong balance sheet), and Siliconware (an attractively valued tech laggard).

Sector recommendations

We raise slightly further our exposure to cyclicals at the expense of defensives.

Despite the relative underperformance of defensives in Q1, they generally remain very expensive. **Utilities** in Asia ex Japan, for example, trade on 16.4x 2009 earnings and **consumer staples** on 13.5x. We think that many investors are still very overweight these sectors, having built up positions as the stock market collapsed last year. The **telecoms** sector has seen stock prices fall in recent months, bringing PE back to a reasonable 10.5x. But regulatory risk and excess competition remain a risk in many markets in Asia, particularly in China (where we see China Mobile trying to grow 3G subscribers at the expense of short-term profitability) and India (where Reliance Communications is doing something similar with GSM). We cut telecoms, **healthcare** and utilities to underweight from neutral. We leave consumer staples at neutral, because parts of it (for example, supermarkets) have some structural growth drivers and are not just purely defensive.

It is a tougher call to know where to take the cyclical exposure. As we argued last quarter, it is probably better to do this via quality stocks rather than being too choosy about which industries within the cyclicals universe to focus on.

We keep our overweight on **industrials,** which we see as less risky, since some of the sector's earnings come from public-sector and infrastructure-related capex. We particularly like machinery companies in Japan and China, and airlines (which should benefit from cheaper jet fuel as well as being early plays on a recovery in consumption). We continue to avoid shippers and shipbuilders, which suffer from gross over-capacity.

Later cyclical plays, such as consumer-related sectors, are probably still a couple of quarters away from outperforming, since employment and wages are still falling. But we raise our weighting in **consumer discretionary** to neutral, since it is probably better to get in early than wait and miss the bounce. This sector is exposed both to Asian consumption and to a pick-up in US consumption for products such as autos and electronic goods. While neither is likely to be strong, valuations more than reflect that, in our view, with the sector PE at 11.0x for 2009 and 9.2x for 2010.

We also believe it is too early to take an overweight position in **financials**, since the problems with US and European banks are far from being solved, which will drag the sector down globally, and NPLs in Asia are likely to rise. But there is probably more upside than downside risk in this sector now (healthy banks in Asia might rebound strongly if the US moves to nationalise some banks, for instance) and so we think an underweight is risky. We raise our weighting to neutral and would take positions particularly in Taiwanese and Indian banks; we are neutral on Chinese banks and cautious in Australia, Japan, and Korea. We are generally, though, underweight **real estate** (which MSCI classifies under financials), which is exposed to refinancing risk as well as to the likelihood that real estate prices in a range of markets, from India to China and Japan, will fall further.

In retrospect, we were wrong to be underweight on **technology** in Q1 (although we did include a number of blue-chip stocks in our Super 10 which performed nicely). There is still some upside risk over the next few months from restocking, although most of the (slightly) better news is already priced in – to semiconductors in particular. With end-demand likely to stay weak as sales of PCs and handsets will struggle this year, we would not chase this sector. But it is also probably best to have a reasonable exposure so we are raising our recommendation to neutral. We would look for laggards, for example among components companies or panel-makers.

Despite our slight bias to cyclicals, we are unenthusiastic about the **materials** sector, which we lower to underweight from neutral. While demand in some areas is likely to bottom out this year, this sector has the added problem of increasing supply. This is likely to depress prices in a range of areas including coal, steel, aluminium and iron ore. Since the last bull market was driven by resources, it is highly unlikely that the next one will be.

We keep our overweight in **energy**. We expect the crude oil price to be flat to slightly uptrending over the next 12 months (our analysts forecast an average of USD52 a barrel this year and USD76 next). But the main reason for our overweight is that in both China and India liberalisation of retail energy prices will raise refiner margins.

Main markets

Japan (neutral)

- Economic numbers have deteriorated dramatically
- But political impasse is set to continue and structural risks are rising
- Japan is too cyclical to underweight, too risky to overweight

Cyclical buy too risky

Japan's economy has deteriorated dramatically in recent months: exports are falling 49% y-o-y, industrial production 38% and department store sales 12%. We estimate that in Q1 real GDP fell 7.9% y-o-y.

From a contrarian point of view, that perhaps makes Japan interesting for investors wanting to take some cyclical exposure. As in other cyclical markets such as Taiwan and Korea, data should bottom out over the next couple of quarters. There is, for example, an 82% correlation between MSCI Japan and the US ISM manufacturing index (compared to 76% for Taiwan and 70% for China) – which should pick up in coming months.

Moreover, the Japanese market looks fairly cheap. PB is 1.0x, slightly above the low of 0.8x reached in March, but well below the post-2003 average of 1.6x. (Note, though, that 12-month forward PE is 27x after earnings collapsed.)

We think, therefore, that it is unwise to be underweight Japan in an environment where newsflow should continue to improve. However, there are a number of reasons why we would not recommend an overweight. The political situation will remain shaky until (and probably after) the general election which must be held by September 6. Excitement about a regime change, with the LDP losing power, has been undermined by the recent arrest on bribery charges of the secretary of Democratic Party leader Ichiro Ozawa. Continued stalemate is the most likely outcome.

The negative impact of the economic slowdown could drag on for some time. We expect q-o-q GDP growth to continue to fall until Q4, although the rate of decline will slow. Even in September, we forecast that industrial production will still be down 35% over a year earlier – and Japanese equities have traditionally had a close correlation with this data series. Japan's high ratio of outstanding debt to GDP (and the political impasse) plus interest rates that have long been close to zero mean the room for monetary and fiscal stimulus is limited.

There are some structural implications too. Electronics manufacturers will make big losses in the fiscal year ending March 2009: Hitachi (6501 JP), for example, forecasts it will lose JPY700bn, equal to 21% of its shareholders' equity. Bankruptcy risk among smaller export-oriented manufacturers is rising. In combination with sharp falls in real estate prices, this will put pressure on banks too. Furthermore, we expect the yen to decline to JPY105 to the dollar by year-end, which will dampen equity returns.

We would take some exposure to machinery and IT, but avoid banks and outright defensive sectors such as pharmaceuticals and utilities.

1. Returns (%, USD)

	MSCI Japan	TOPIX
3-month	-8.9	-1.7
6-month	-26.1	-30.4
12-month	-33.0	-33.6
24-month	-45.1	-53.3

2. Valuation

	2009	2010
PE (X)	33.4	17.7
P/B (X)	0.9	1.0
Dividend yield (%)	2.2	2.3

3. Q1 2009 sector performance %

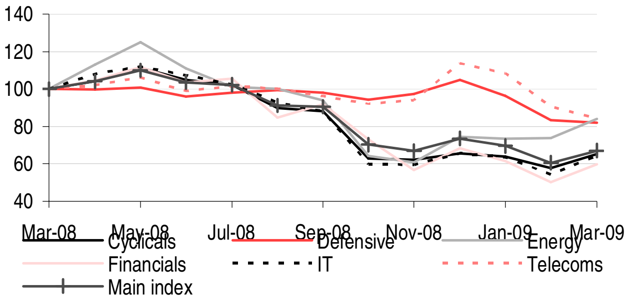
Sector	Perf	Sector	Perf
Energy	12.7	Financials	-12.5
Consumer Discretionary	5.2	Health Care	-20.0
Technology	-2.2	Utilities	-21.0
Materials	-3.0	Telecom	-26.0
Industrials	-5.5	Consumer Staples	-26.3

4. Earnings (%)

	2009	2010
Earnings growth (y-o-y)	-11.8	88.5
ROE	2.7	5.6
ROA	0.7	0.7
Net debt/ equity ratio	0.0	0.0

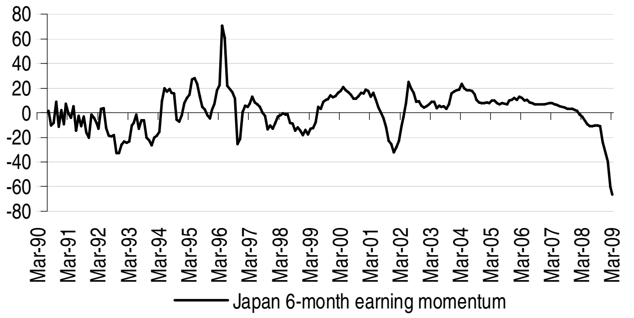
Notes: Performance for Q1 2009 is up to 24 Mar 2009; ^^ for full explanatory notes Valuation & Earnings tables, please see Databook section on page 48; Source: HSBC, I/B/E/S

5. Market performance



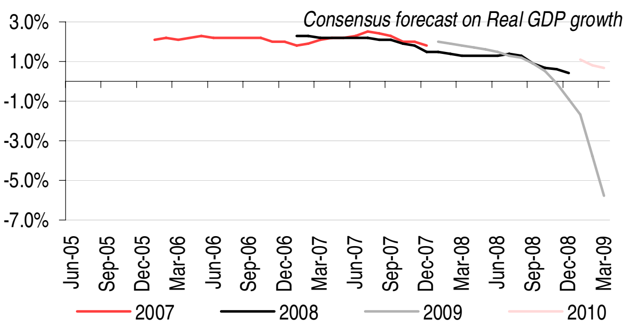
Source: HSBC

6. Earnings momentum



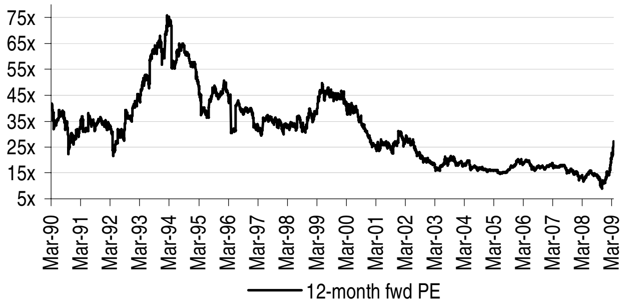
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



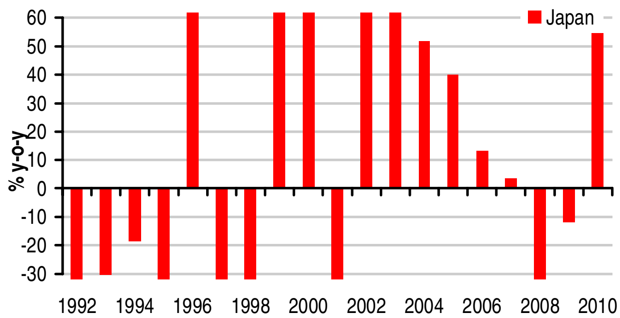
Source: Consensus Economics, HSBC

8. Valuation



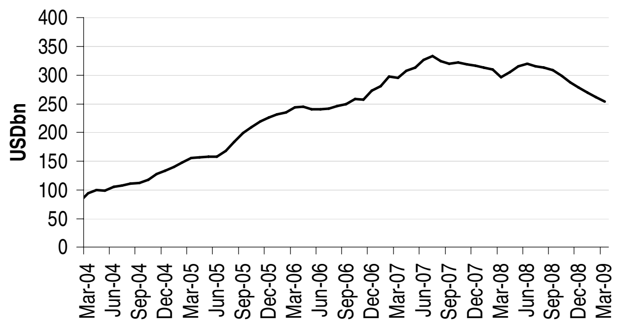
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: Bloomberg, HSBC

China (neutral) & Hong Kong (neutral)

- Sharp market rebound is pricing in a swift economic recovery
- Downgrade MSCI China to neutral
- Rotate from cyclicals to banks

Good news priced in for now

The latest batch of Jan-Feb. economic statistics shows that domestic demand, particularly public sector investment, has held up better than expected to partially offset the worse-than-expected external slowdown. Moreover, China's banking sector has lent nearly RMB4trn in the four months until February, though 40% of this was short-term discounted bills. Demand and production growth of cyclical sectors such as electricity, cement, steel, coal and autos have rebounded from historical low levels and further improvement in the near term appears under way, as indicated by PMI leading indicators.

MSCI China has rebounded over 50% from its trough at the end of October, largely pricing in a swift economic recovery in our view. Since 1995, the 12-month forward PE for MSCI China has traded in a wide range of 5-35x. The current valuation of 11.1x appears a reasonable level compared to the recent trough of 6x and the average of 13x since 1995. Our 2009 index targets remain unchanged: 16,000 for HSI, 9,000 for HSCEI (H-share), 3,500 for HSCCI (red-chip) and 2,300 for SHCOMP (A-share). We downgrade China to neutral as upside to our targets is now limited.

The market could be volatile in 2Q09 as: 1) views are still divided on the sustainability of China's recovery and the effectiveness of developed countries' fiscal/monetary policy mix in reviving credit markets and economic growth, particularly next year; 2) industrial enterprises' profit growth may not return to positive territory until 2H09. Our top-down profit forecast model, based on seasonally adjusted M1 growth, suggests y-o-y profit growth could remain negative 20-30% for the first three quarters and turn positive (+5-10%) only in 4Q09. On a sequential basis, q-o-q profit growth could turn positive in 2Q09.

Our sector allocation strategy of overweighting cyclicals at the cost of banks and telecoms has been in place since 4Q08 (see China Investment Atlas, issue 17, page 14). We think investors should take profit on materials and IT sectors; we downgrade both to underweight. Given the stabilising A-share market, lower probability of asymmetrical rate cuts and potential improvement in loan mix, we raise the banking sector to neutral. We retain overweights on energy, IPPs and consumer staples; neutral on capital goods, insurance, consumer discretionary, airlines and property; and underweight on telecoms.

China

1. Return (%, USD)

	MSCI China	HSCEI
3-month	5.1	4.9
6-month	-14.6	-17.2
12-month	-28.2	-25.6
24-month	-16.9	-15.0

2. Valuation

	2009	2010
PE (X)	11.6	9.9
P/B (X)	1.6	1.5
Dividend yield (%)	3.1	3.5

3. Q1 2009 sector performance %

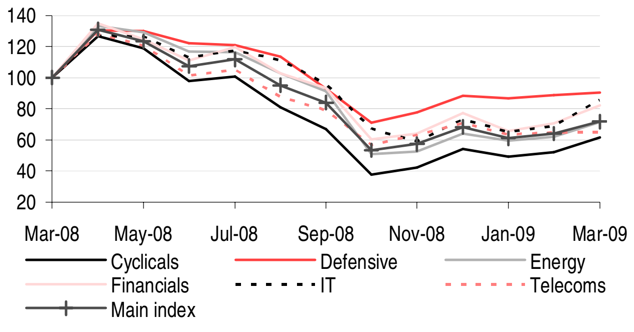
Sector	Perf	Sector	Perf
Materials	25.9	Industrials	5.6
Technology	17.2	Utilities	5.1
Consumer Discretionary	16.2	Consumer Staples	0.0
Energy	11.7	Telecom	-8.2
Financials	6.1		

4. Earnings (%)

	2009	2010
Earnings growth (y-o-y)	1.4	17.6
ROE	13.5	15.6
ROA	2.1	2.3
Net debt/ equity ratio	-72.7	-74.6

Notes: Performance for Q1 2009 is up to 24 Mar 2009; ^^ for full explanatory notes Valuation & Earnings tables, please see Databook section on page 48; Source: HSBC, I/B/E/S

5. Market performance

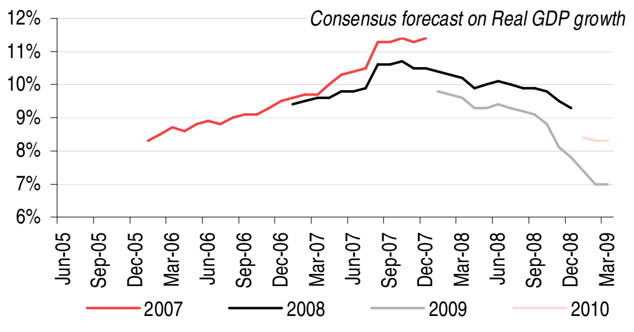


Source: HSBC

6. Earnings momentum

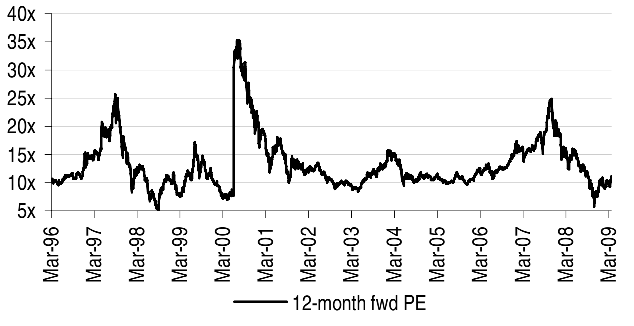
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



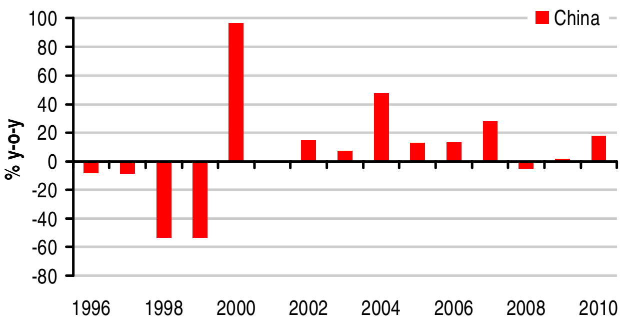
Source: Consensus Economics, HSBC

8. Valuation



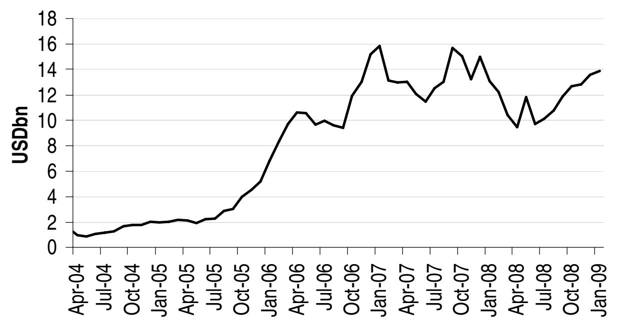
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

Hong Kong

1. Return (%, USD)

	MSCI Hong Kong	HSI
3-month	4.3	-1.9
6-month	-21.2	-26.6
12-month	-35.4	-34.1
24-month	-33.0	-29.4

2. Valuation

	2009	2010
PE (X)	14.5	13.1
P/B (X)	0.9	0.9
Dividend yield (%)	3.7	3.9

3. Q1 2009 sector performance %

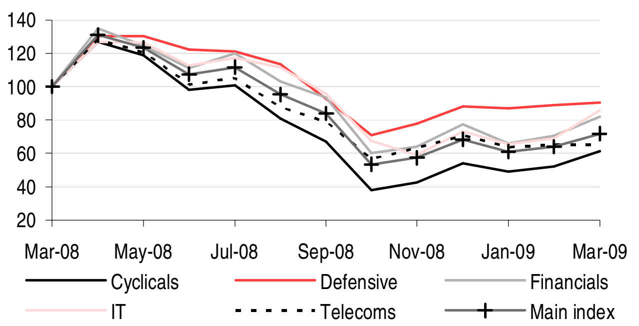
Sector	Perf	Sector	Perf
Telecom	37.4	Industrials	6.2
Technology	23.1	Financials	0.6
Consumer Discretionary	15.9	Energy	0.4
Utilities	6.5		

4. Earnings (%)

	2009	2010
Earnings growth (y-o-y)	-17.6	10.4
ROE	6.3	7.2
ROA	2.7	2.7
Net debt/ equity ratio	17.6	18.6

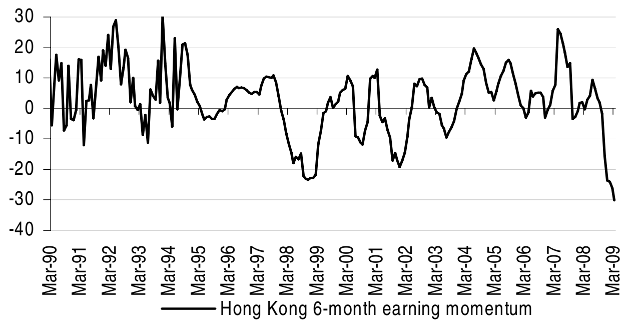
Notes: Performance for Q1 2009 is up to 24 Mar 2009; ^^ for full explanatory notes Valuation & Earnings tables, please see Databook section on page 48; Source: HSBC, I/B/E/S

5. Market performance



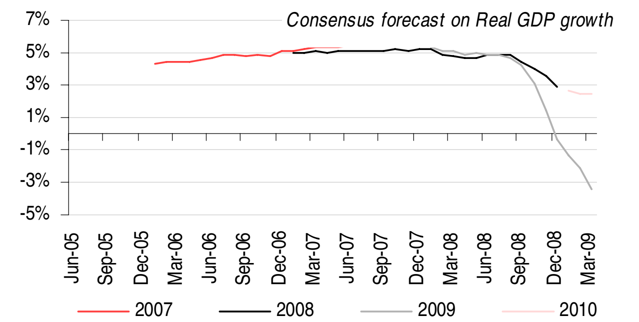
Source: HSBC

6. Earnings momentum



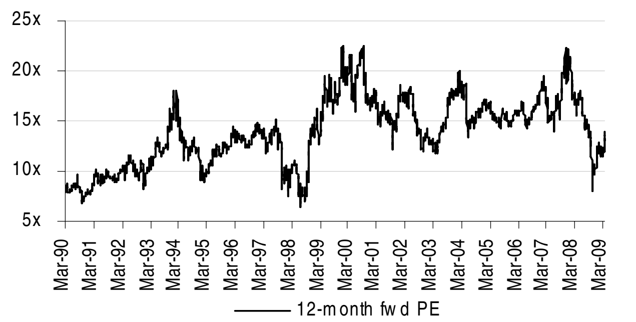
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



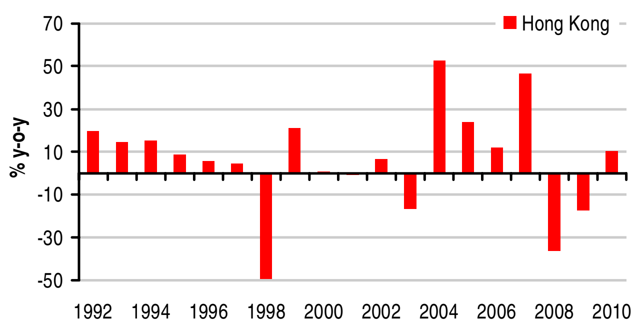
Source: Consensus Economics, HSBC

8. Valuation



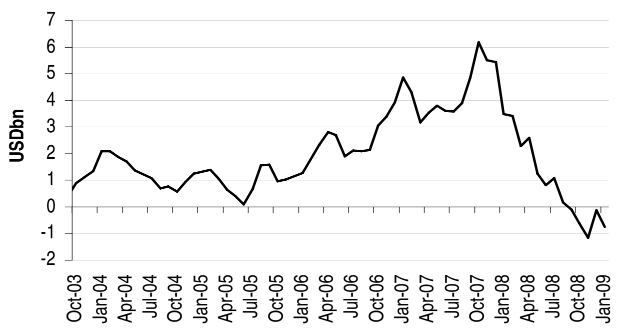
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

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HSBC

Korea (underweight)

- Economic data should bottom over the next few quarters
- But investors can find cyclical exposure elsewhere at less risk
- Analysts' forecasts are too high, valuations not particularly cheap

Look for cyclicality elsewhere

Like Japan and Taiwan, Korea would seem to offer attractions for investors who believe cyclical indicators will start to turn up over the coming months. Exports have already showed the first signs of bottoming: February shipments rose 2% m-o-m, adjusted for the Lunar New Year, although were still down 26% y-o-y for January and February combined. HSBC economics research forecasts real GDP growth will come in at -8.0% y-o-y in Q1 but gradually move into positive territory by Q4. The government plans a range of measures to offset the slowdown, from guaranteeing loans to SMEs to fiscal stimulus that, as announced, totals KRW49trn (5.2% of GDP).

In our view, however, there are risks in overweighting Korean equities. Since there are other markets in which to take similar cyclical exposure without such risks, we find Korea relatively unattractive. What are the risks?

Less bad news is built into forecasts for Korea than in other markets. Analysts' consensus forecasts look for MSCI Korea earnings to be flat y-o-y in 2009 – more optimistic than forecasts for comparable countries such as Taiwan (-59%) or Singapore (-23%). Analysts forecast an optimistic 49% rebound in earnings next year.

And, despite these earnings forecasts, valuations are not noticeably cheap. PE, for example, is 12.4x prospective earnings. Since 2001, average PE for Korea has been 9x. PB, at 1.1x, is below the regional average of 1.4x but PB in Korea bottomed at a much lower level in previous cycles.

We are concerned that some of the structural side-effects from the sharp economic slowdown have yet to show through. Companies have only just started to lay off workers. Banks' NPLs are likely to rise as over-indebted companies struggle with losses. Minister of Finance, Yoon Jeung-hyun recently stated: "We are in a stage where the depth of the problem at the financial and corporate sectors has not yet been fully revealed."

Korea has a high ratio of short-term external debt (defined as that maturing in the next 12 months, irrespective of original maturity) to FX reserves. Korean corporates are having to pay a premium to fund themselves in the external market. Banks also have a high loan/deposit ratio, meaning they are somewhat dependent on wholesale funding.

Though we stay underweight Korean equities, we would take some benchmark exposure to cyclical sectors such as tech, industrials and consumer discretionary. We also like telecoms, where subsidies are falling. We are underweight banks.

1. Returns (%, USD)

	MSCI Korea	KOSPI
3-month	3.0	8.3
6-month	-32.0	-18.3
12-month	-46.4	-26.2
24-month	-43.4	-15.6

2. Valuation

	2009	2010
PE (X)	13.9	9.3
P/B (X)	1.0	1.0
Dividend yield (%)	0.4	0.5

3. Q1 2009 sector performance %

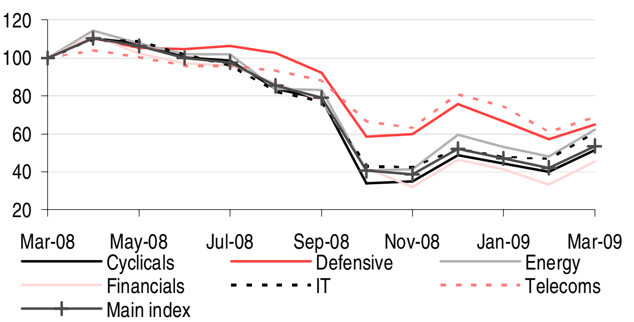
Sector	Perf	Sector	Perf
Technology	16.3	Financials	-1.8
Consumer Discretionary	14.1	Utilities	-14.3
Energy	4.1	Consumer Staples	-14.7
Materials	2.0	Telecom	-14.8
Industrials	1.7	Health Care	-16.0

4. Earnings (%)

	2009	2010
Earnings growth (y-o-y)	-0.2	48.5
ROE	7.4	10.9
ROA	1.8	2.2
Net debt/ equity ratio	0.0	0.0

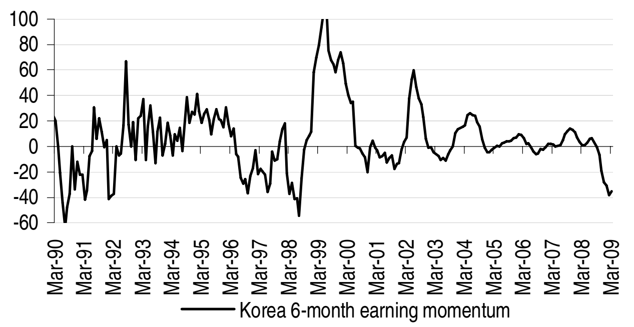
Notes: Performance for Q1 2009 is up to 24 Mar 2009; ^^ for full explanatory notes Valuation & Earnings tables, please see Databook section on page 48; Source: HSBC, I/B/E/S

5. Market performance



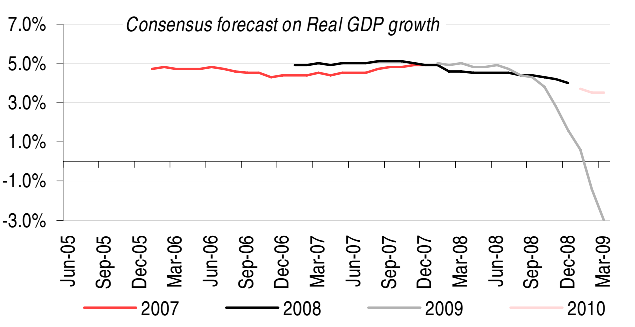
Source: HSBC

6. Earnings momentum



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

7. Economy

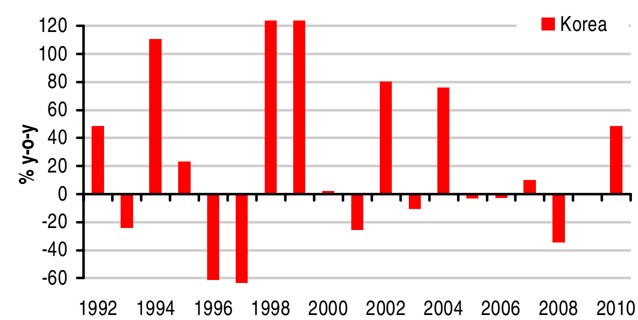


Source: Consensus Economics, HSBC

8. Valuation

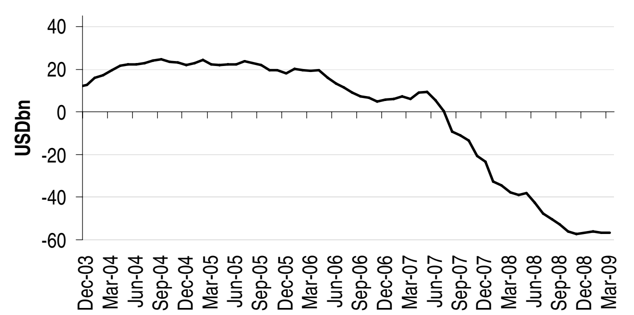
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: Bloomberg, HSBC

HSBC

Taiwan (overweight)

- We raise to overweight based on realistic forecasts, strong balance sheets and the cross-Strait catalyst
- Key is identifying sectors that have priced in most of the bad news
- We recommend overweights on technology and financials

Toughened up by hard times

We raise Taiwan to overweight from neutral based on lowered expectations, strong balance sheets and the catalyst of improving cross-Strait relations. Since the turn of the millennium, Taiwan has experienced a harsh time with the tech bubble burst and then a depressed economy under cross-Strait tensions. But Taiwan learned some valuable lessons from these episodes that may make its equity market more resilient than others in the current downturn.

First, analysts covering Taiwan learned to price in the downturn at first sight of the problem. Forecasts for 2009 earnings have been revised down by 79% over the past six months. This is the sharpest revision in Asia ex-Japan, almost double that in Korea. Above all, tech analysts have been the most agile, bringing earnings down by 103% over the past six months; they now forecast a loss for the sector in 2009. With rush orders starting to come in, partly helped by the stimulus package in China, this sector is more likely to surprise on the upside from here on. Thus, we raise tech to overweight from underweight.

Second, companies now have much stronger balance sheets to help them weather the crisis: 40% of listed companies have net cash, including some heavyweights such as HTC and Mediatek (net debt/equity ratios are -102% and -53% respectively). The weighted average net debt/equity ratio in Taiwan is 5%, compared to 15% in Singapore and 39% in Korea. Lower leverage makes investing in Taiwan more comfortable than in other markets during a credit crunch.

Lastly, realising that a stand-still with Beijing will not help to revive the economy, the more market-friendly KMT government is gearing up for the third round of cross-Strait negotiations which will focus on financial cooperation. We do not believe that the short-term benefits to Taiwanese banks of doing business in the mainland will be more than minimal, but a successful agreement will be a good catalyst to boost sentiment. We maintain overweight on financials.

Our economist expects GDP to contract by 6.2% in 2009 and the unemployment rate to rise to 6.4%, higher than during the 2001 tech bust. We acknowledge the weakness in the economy and see possible downside risk from slack domestic demand. But cautiously picking well-managed blue chip companies in this market should be a relatively safe way to get cyclical exposure. With this backdrop, we raise Taiwan to overweight and have tech and financials as our favourite sectors.

1. Returns (%, USD)	MSCI Taiwan	TSE
3-month	14.9	18.5
6-month	-22.7	-14.5
12-month	-49.0	-40.9
24-month	-39.0	-33.3

2. Valuation	2009	2010
PE (X)	45.3	15.3
P/B (X)	1.4	1.4
Dividend yield (%)	4.0	4.1

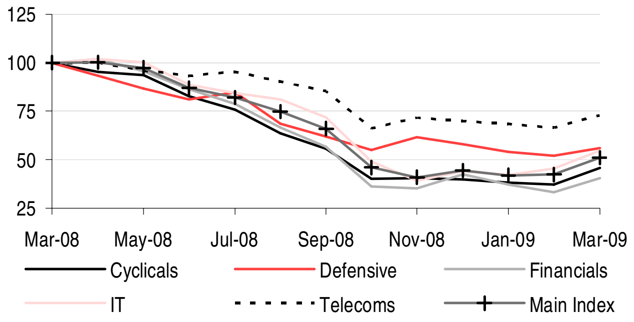
3. Q1 2009 sector performance %

Sector	Perf	Sector	Perf
Technology	23.8	Telecom	4.3
Consumer Discretionary	18.0	Energy	-1.9
Materials	15.1	Consumer Staples	-3.7
Industrials	13.9	Financials	-4.4

4. Earnings (%)	2009	2010
Earnings growth (y-o-y)	-59.2	195.3
ROE	3.0	9.3
ROA	0.8	-9.7
Net debt/ equity ratio	-6.7	-11.2

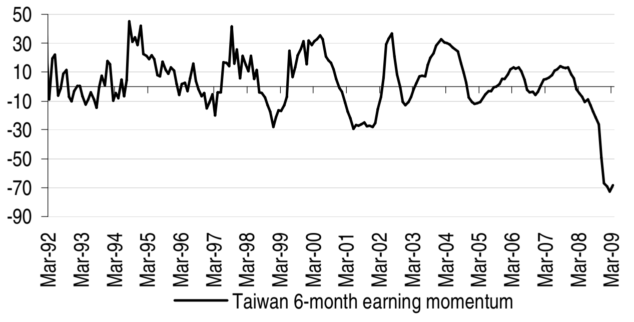
Notes: Performance for Q1 2009 is up to 24 Mar 2009; ^^ for full explanatory notes Valuation & Earnings tables, please see Databook section on page 48; Source: HSBC, I/B/E/S

5 Market performance



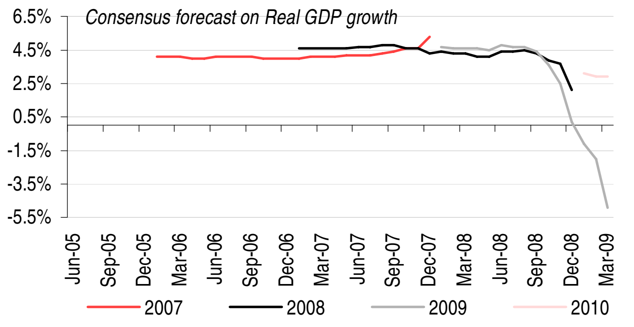
Source: HSBC

6. Earnings momentum



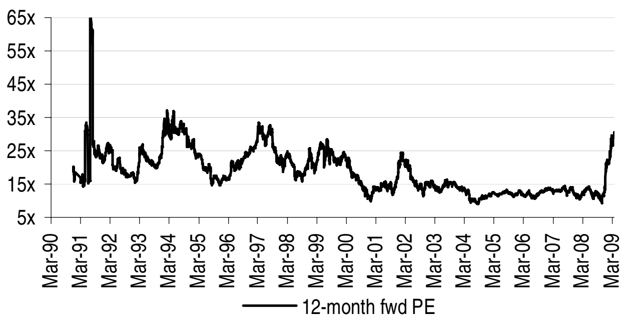
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



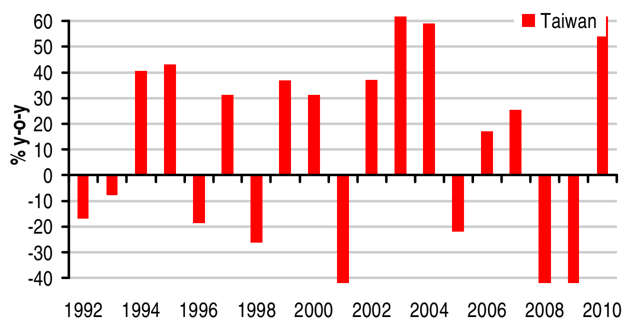
Source: Consensus Economics, HSBC

8. Valuation



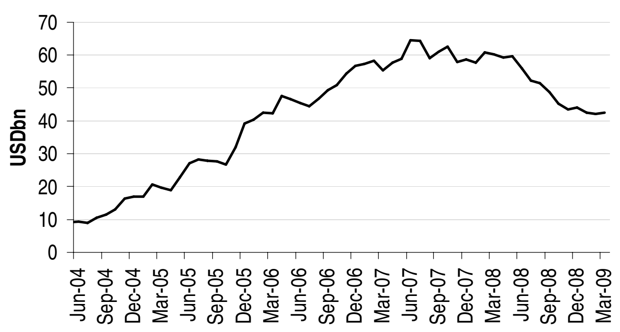
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: Bloomberg, HSBC

India (overweight)

- Earnings and GDP growth likely to provide positive surprises
- Elections and the state of public finances are the major risks
- We upgrade banks to overweight

Pessimism overdone

India's valuation premium has shrunk in the past five months and Indian markets are now cheaper than many peers. For example, India's PE of 11.4x is lower than Korea, Malaysia and Taiwan, and similar to China – all markets to which it has typically traded at a premium.

Moreover, prospects for corporate earnings in India are stronger than for other Asian markets. We expect earnings for MSCI India to grow 5-10% in CY2009e (against a consensus expectation of 3.6%), whereas consensus for Asia ex Japan is for earnings to drop by 11%.

Our economics team forecasts Indian GDP to grow by about 6% this year, which makes India the second fastest growing economy in the region. While this represents a significant slowdown and economic conditions will be tough, relatively speaking it is a stellar performance compared to most economies. Also, we expect the quarter ending June 2008 to be the trough of the economic cycle, with growth accelerating in late 2009/early 2010, on account of the lagged effects of monetary easing, fiscal stimulus, the decline of commodity prices and additional oil and gas output.

What will matter towards the latter half of the year, however, will be the outlook for CY2010, when we expect the economy to grow at 7.6%, and corporate earnings to grow close to trend levels of 10-12%.

We doubt if this is priced in. At the current index level, the market is implying flat to a 10% decline for corporate earnings. The market may be pleasantly surprised towards the end of 2009.

India's markets face two major risks: one is an event risk (the election), and the second is a structural risk arising out of the state of public finances.

We think the next government is likely to be a coalition anchored by the BJP or Congress Party. Most recent opinion polls indicate that the Congress-led coalition has the edge but elections are difficult to call.

India has one of the world's highest ratios of outstanding public debt as a percentage of GDP, and the current fiscal slippage is a concern. Fiscal consolidation will be a key task for the next government. In the past, economic reforms have been triggered by economic crisis, and a Congress or BJP-led government may accelerate economic reforms, which would boost sentiment.

In our sector recommendations, we are overweight banks (which we upgrade from underweight) and energy, and underweight consumer discretionary, materials and healthcare.

HSBC

1. Returns (%, USD)

	MSCI India	SENSEX
3-month	-4.6	-1.0
6-month	-38.6	-30.8
12-month	-52.5	-38.1
24-month	-41.3	-28.7

2. Valuation

	2009	2010
PE (X)	11.4	9.8
P/B (X)	1.4	1.5
Dividend yield (%)	2.2	2.5

3. Q1 2009 sector performance %

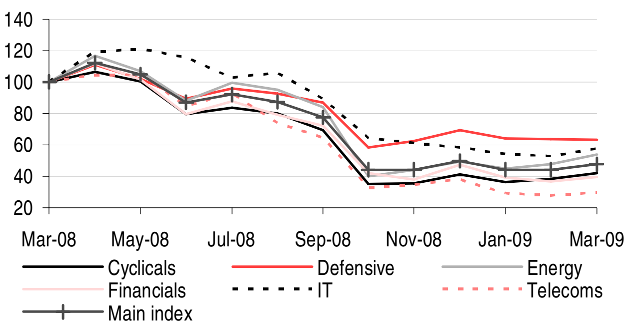
Sector	Perf	Sector	Perf
Consumer Discretionary	13.9	Industrials	-9.6
Energy	9.1	Consumer Staples	-10.7
Materials	8.4	Health Care	-12.1
Technology	-1.1	Financials	-16.9
Utilities	-5.8	Telecom	-22.3

4. Earnings (%)

	2009	2010
Earnings growth (y-o-y)	3.6	15.7
ROE	12.7	14.8
ROA	5.1	4.5
Net debt/ equity ratio	22.7	20.3

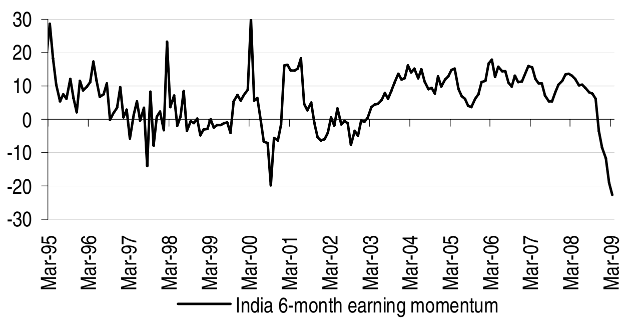
Notes: Performance for Q1 2009 is up to 24 Mar 2009; ^^ for full explanatory notes Valuation & Earnings tables, please see Databook section on page 48; Source: HSBC, I/B/E/S

5. Market performance



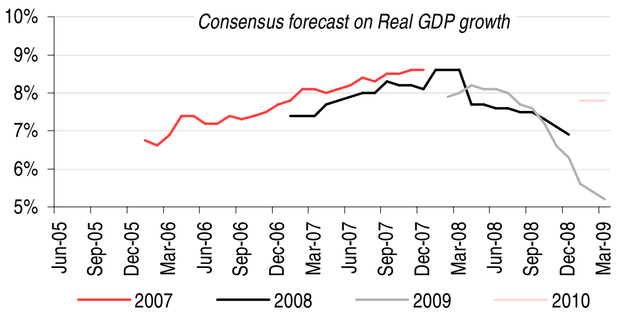
Source: HSBC

6. Earnings momentum



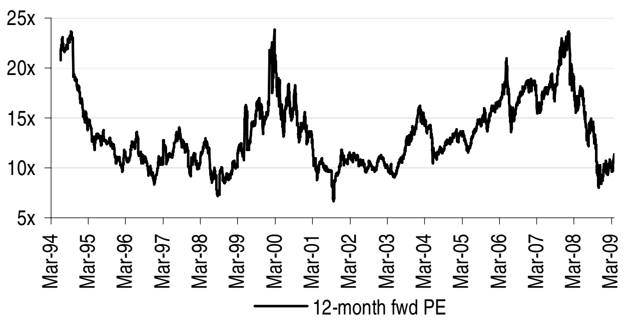
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



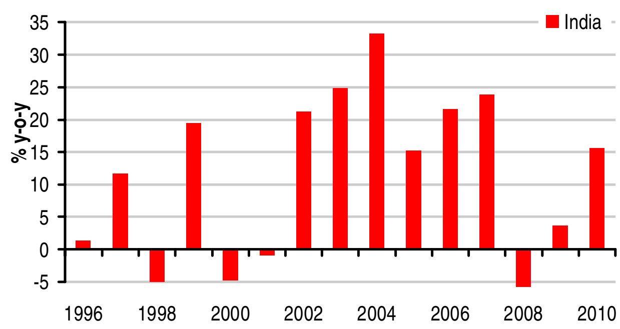
Source: Consensus Economics, HSBC

8. Valuation



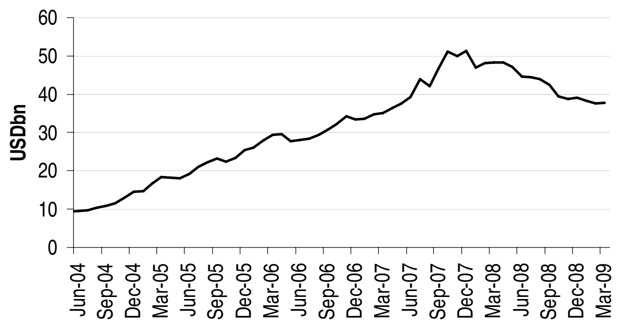
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: Bloomberg, HSBC

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Other markets

Australia

1. Return (%, USD)

	MSCI Australia	S&P/ ASX 200
3-month	3.5	-0.1
6-month	-38.5	-28.1
12-month	-43.9	-30.2
24-month	-45.7	-39.9

2. Valuation

	2009	2010
PE (X)	12.0	11.0
P/B (X)	1.4	1.5
Dividend yield (%)	5.6	6.0

3. Q1 2009 sector performance %

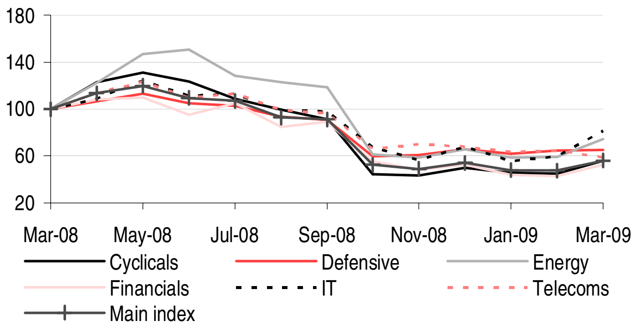
Sector	Perf	Sector	Perf
Technology	19.7	Consumer Discretionary	-1.4
Materials	16.9	Utilities	-4.0
Energy	13.7	Health Care	-9.3
Consumer Staples	2.2	Telecom	-13.6
Financials	0.1	Industrials	-16.8

4. Earnings (%)

	2009	2010
Earnings growth (y-o-y)	-7.1	9.0
ROE	11.4	13.4
ROA	2.5	2.7
Net debt/ equity ratio	273.4	292.6

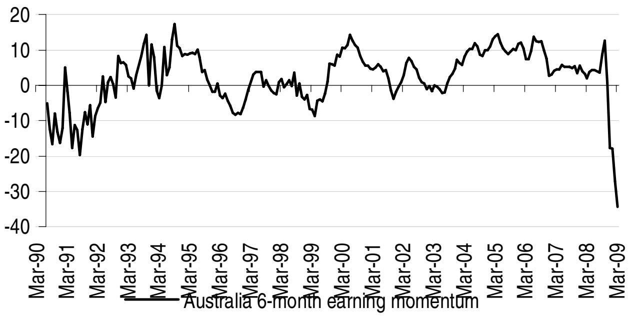
Notes: Performance for Q1 2009 is up to 24 Mar 2009; ^^ for full explanatory notes Valuation & Earnings tables, please see Databook section on page 48; Source: HSBC, I/B/E/S

5. Market performance



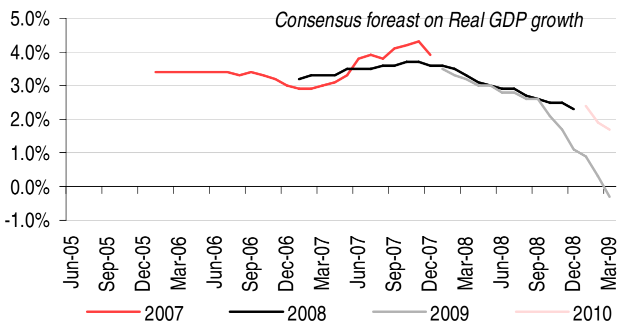
Source: HSBC

6. Earnings momentum



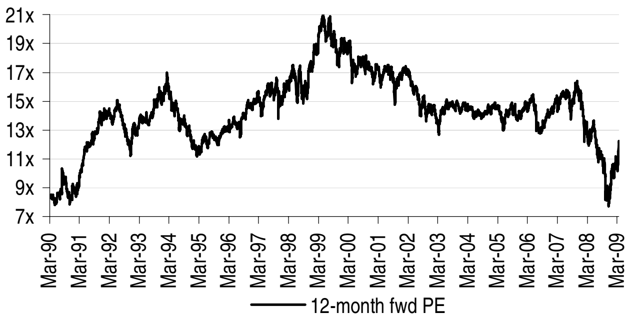
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



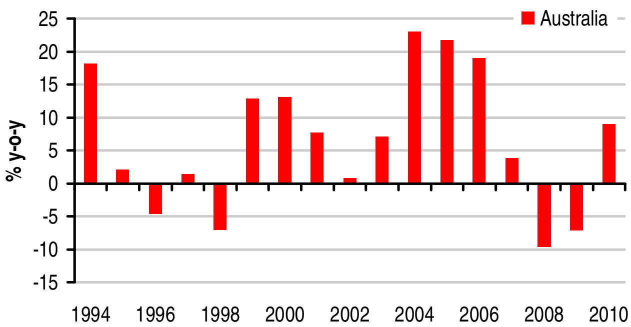
Source: Consensus Economics, HSBC

8. Valuation



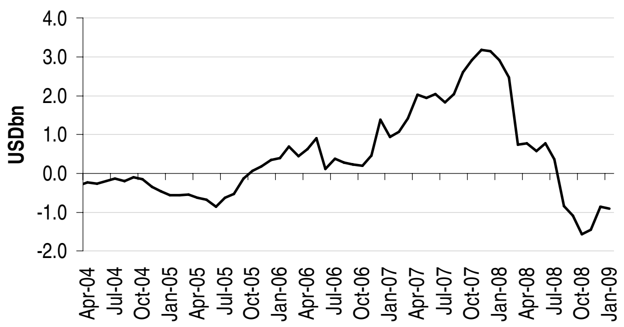
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

Singapore

1. Return (%, USD)

	MSCI Singapore	STI
3-month	-6.4	-1.8
6-month	-36.5	-31.1
12-month	-48.2	-41.7
24-month	-47.6	-45.7

2. Valuation

	2008	2009
PE (X)	9.4	10.4
P/B (X)	1.1	1.1
Dividend yield (%)	5.3	5.2

3. Q1 2009 sector performance %

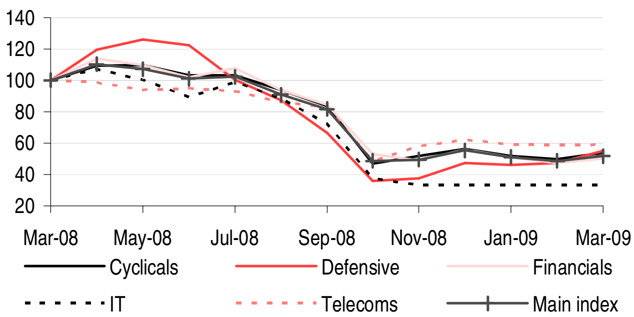
Sector	Perf	Sector	Perf
Consumer Staples	21.674	Financials	-10.3
Industrials	-2.298	Health Care	-12
Telecom	-4.674	Consumer Discretionary	-12

4. Earnings (%)

	2008	2009
Earnings growth (y-o-y)	-23.0	#N/A
ROE	12.2	10.6
ROA	2.7	2.1
Net debt/ equity ratio	7.9	5.4

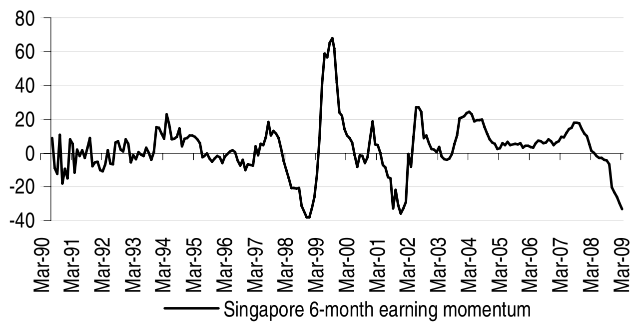
Notes: Performance for Q1 2009 is up to 24 Mar 2009; ^^ for full explanatory notes Valuation & Earnings tables, please see Databook section on page 48; Source: HSBC, I/B/E/S

5. Market performance



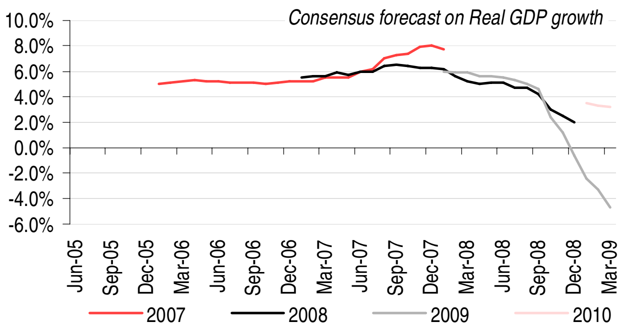
Source: HSBC

6. Earnings momentum



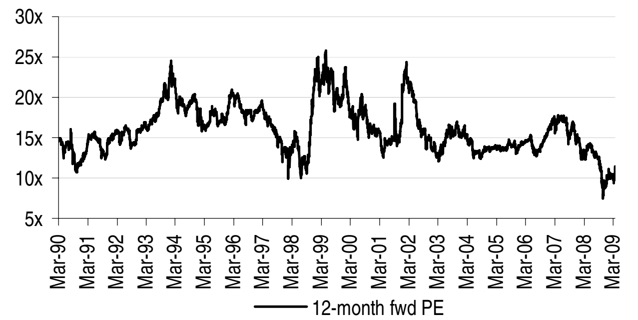
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



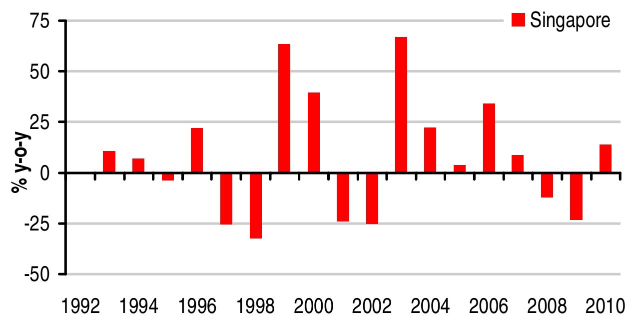
Source: Consensus Economics, HSBC

8. Valuation



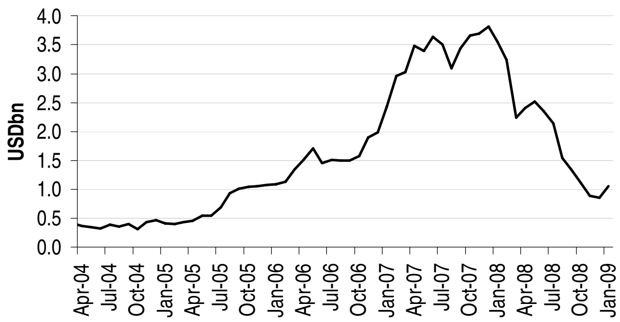
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

Malaysia

1. Return (%, USD)

	MSCI Malaysia	KLSE
3-month	-1.4	1.0
6-month	-18.3	-14.6
12-month	-36.3	-26.9
24-month	-33.0	-29.0

2. Valuation

	2009	2010
PE (X)	13.0	11.8
P/B (X)	1.4	1.3
Dividend yield (%)	4.2	4.5

3. Q1 2009 sector performance %

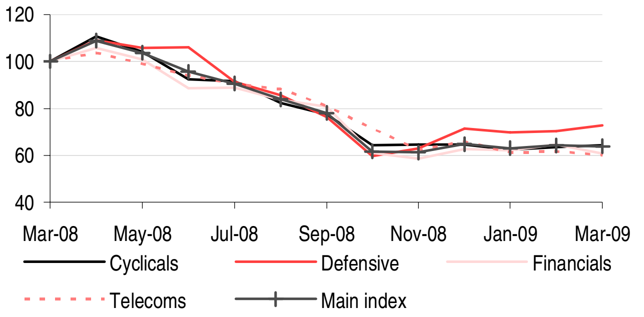
Sector	Perf	Sector	Perf
Consumer Staples	6.4	Financials	-3.3
Industrials	3.7	Energy	-3.9
Materials	-1.6	Consumer Discretionary	-7.3
Utilities	-3.2	Telecom	-8.9

4. Earnings (%)

	2009	2010
Earnings growth (y-o-y)	-16.8	10.4
ROE	10.4	11.3
ROA	2.4	2.5
Net debt/ equity ratio	25.4	25.7

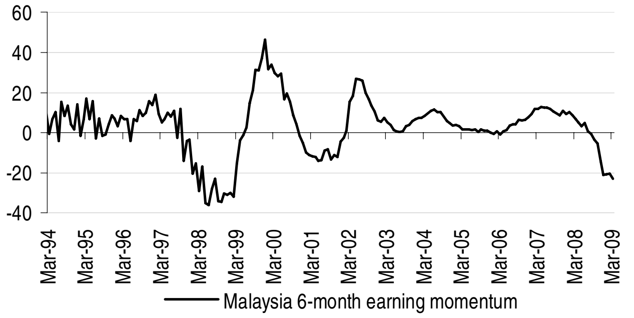
Notes: Performance for Q1 2009 is up to 24 Mar 2009; ^^ for full explanatory notes Valuation & Earnings tables, please see Databook section on page 48; Source: HSBC, I/B/E/S

5. Market performance



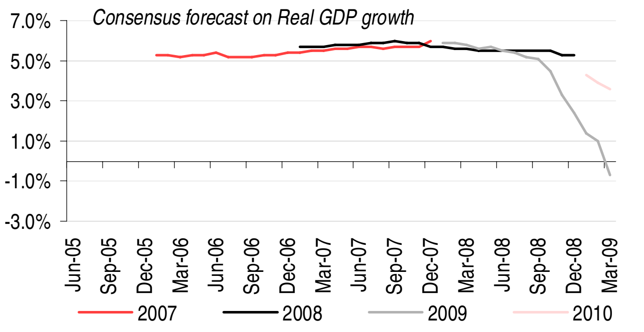
Source: HSBC

6. Earnings momentum



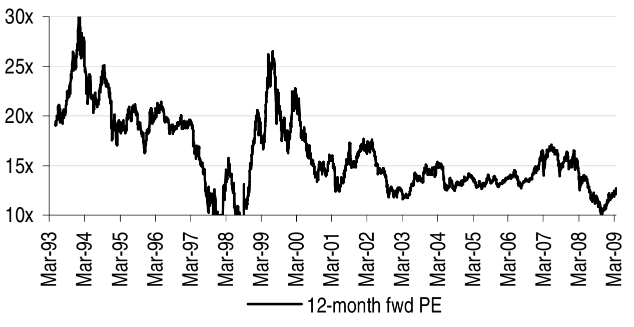
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



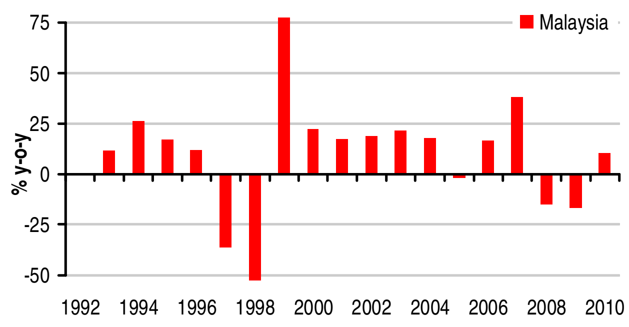
Source: Consensus Economics, HSBC

8. Valuation



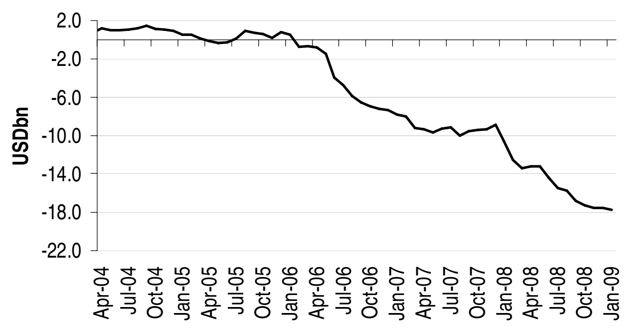
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

Indonesia

1. Return (%, USD)

	MSCI Indonesia	JSX
3-month	4.8	7.4
6-month	-36.0	-23.8
12-month	-51.2	-38.6
24-month	-31.8	-20.5

2. Valuation

	2009	2010
PE (X)	9.8	9.0
P/B (X)	2.3	2.1
Dividend yield (%)	4.4	4.8

3. Q1 2009 sector performance %

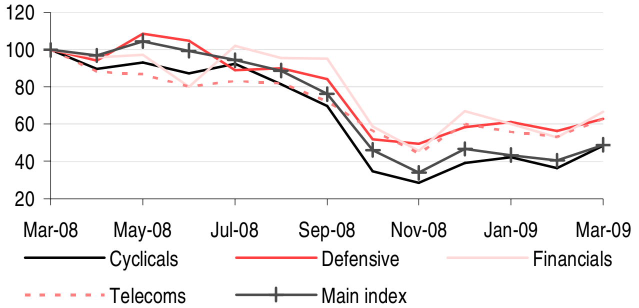
Sector	Perf	Sector	Perf
Consumer Discretionary	37.4	Materials	1.5
Utilities	11.0	Financials	-0.9
Consumer Staples	4.6	Energy	-13.6
Telecom	4.2		

4. Earnings (%)

	2009	2010
Earnings growth (y-o-y)	-6.6	9.1
ROE	23.4	23.0
ROA	5.0	5.1
Net debt/ equity ratio	0.0	0.0

Notes: Performance for Q1 2009 is up to 24 Mar 2009; ^^ for full explanatory notes Valuation & Earnings tables, please see Databook section on page 48; Source: HSBC, I/B/E/S

5. Market performance

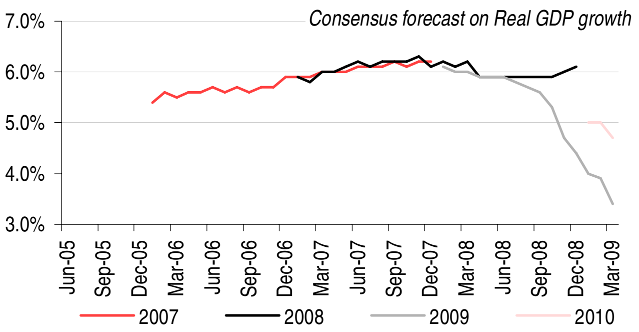


Source: HSBC

6. Earnings momentum

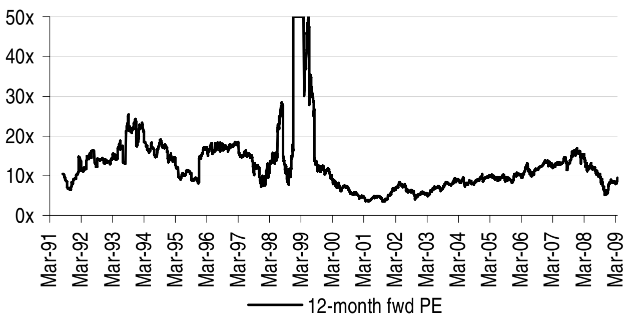
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



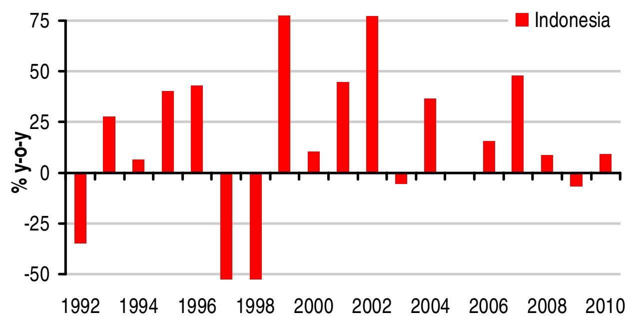
Source: Consensus Economics, HSBC

8. Valuation



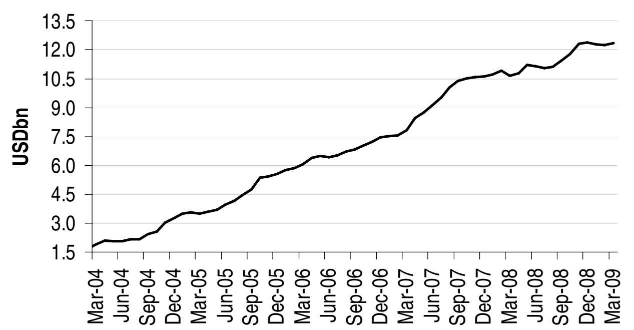
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

Thailand

1. Return (%, USD)

	MSCI Thailand	SET
3-month	-2.1	-0.2
6-month	-32.5	-29.4
12-month	-52.4	-45.7
24-month	-34.8	-35.4

2. Valuation

	2009	2010
PE (X)	8.7	7.5
P/B (X)	1.1	1.0
Dividend yield (%)	5.1	5.8

3. Q1 2009 sector performance %

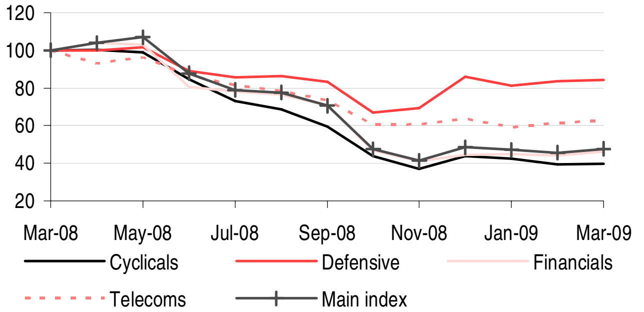
Sector	Perf	Sector	Perf
Financials	4.1	Energy	-5.5
Consumer Staples	3.6	Utilities	-8.1
Telecom	-0.9	Materials	-9.2
Consumer Discretionary	-3.2	Industrials	-23.1

4. Earnings (%)

	2009	2010
Earnings growth (y-o-y)	4.9	15.4
ROE	12.1	13.2
ROA	2.5	2.7
Net debt/ equity ratio	6.5	1.8

Notes: Performance for Q1 2009 is up to 24 Mar 2009; ^^ for full explanatory notes Valuation & Earnings tables, please see Databook section on page 48; Source: HSBC, I/B/E/S

5. Market performance

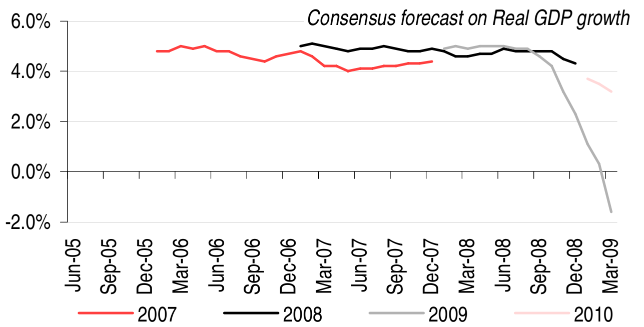


Source: HSBC

6. Earnings momentum

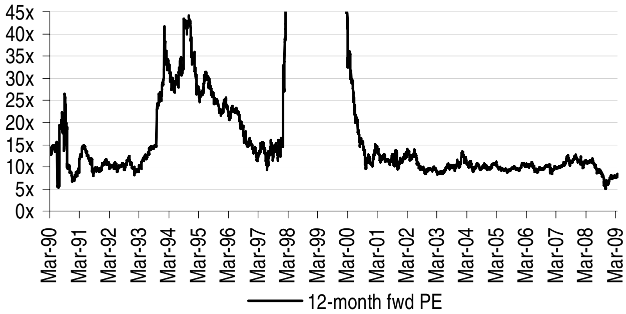
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



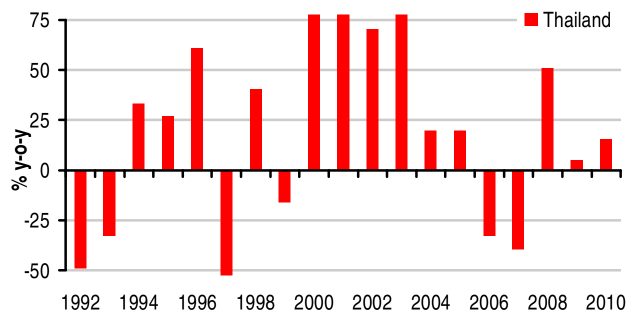
Source: I/B/E/S, HSBC

8. Valuation



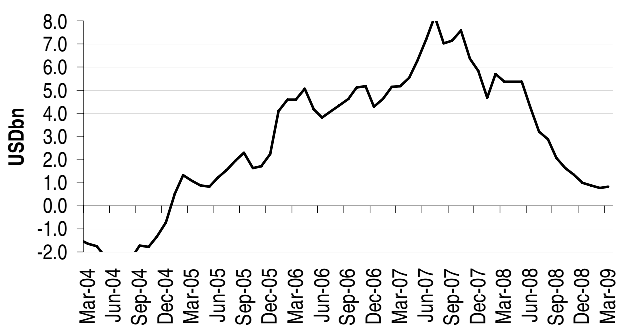
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

Philippines

1. Return (%, USD)

	MSCI Philippines	PSE
3-month	2.3	2.4
6-month	-23.5	-23.6
12-month	-40.0	-33.1
24-month	-39.4	-39.5

2. Valuation

	2009	2010
PE (X)	11.4	10.3
P/B (X)	1.5	1.5
Dividend yield (%)	5.1	5.5

3. Q1 2009 sector performance %

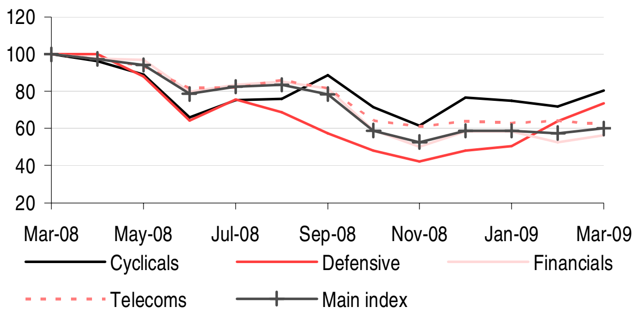
Sector	Perf	Sector	Perf
Utilities	52.8	Telecom	-2.4
Consumer Discretionary	4.7	Financials	-3.9
Industrials	-2.3		

4. Earnings (%)

	2009	2010
Earnings growth (y-o-y)	7.4	11.1
ROE	13.2	14.7
ROA	2.7	2.7
Net debt/ equity ratio	15.5	12.3

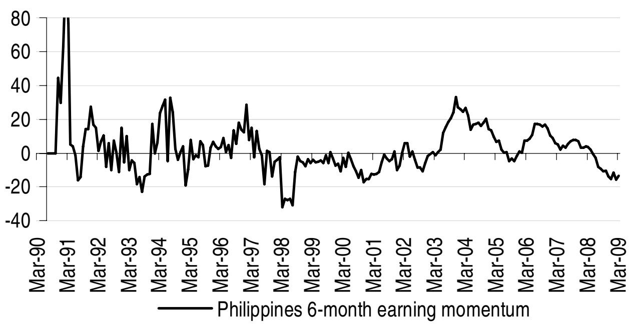
Notes: Performance for Q1 2009 is up to 24 Mar 2009; ^^ for full explanatory notes Valuation & Earnings tables, please see Databook section on page 48; Source: HSBC, I/B/E/S

5. Market performance



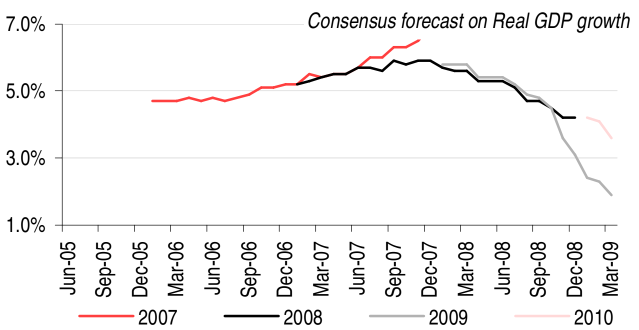
Source: HSBC

6. Earnings momentum



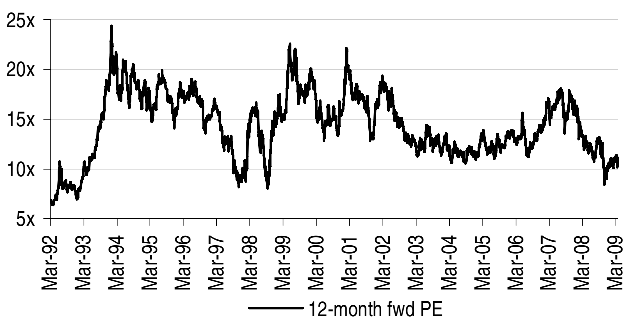
Note: Earnings momentum = 6M % change in 12M forward consensus forecast Source: HSBC

7. Economy



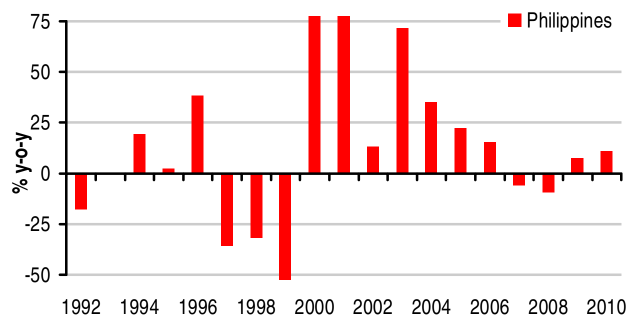
Source: Consensus Economics, HSBC

8. Valuation



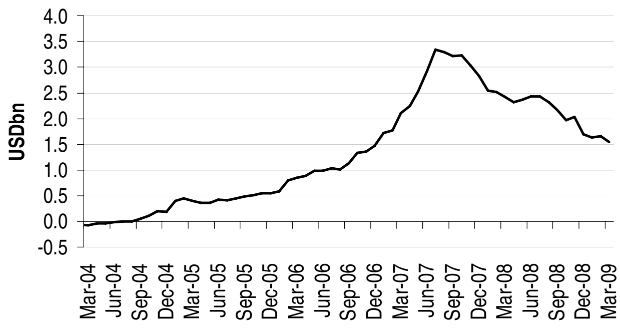
Source: HSBC

9. Earnings



Source: I/B/E/S, HSBC

10. Foreign flows



Source: EPFR, HSBC

HSBC

Datapack

Country/ Sector performance

MSCI indices performance (%)

By country/ region

Countries/Region	Current level	1M	3M	6M	12M	24M
Asia Pacific	84	12.9	-3.0	-27.8	-38.3	-42.5
Asia Ex Japan	292	14.1	3.8	-25.7	-42.6	-35.8
Australia	467	18.3	3.5	-38.5	-43.9	-45.7
China	42	12.0	5.1	-14.6	-28.2	-16.9
Hong Kong	4,849	9.2	4.3	-21.2	-35.4	-33.0
India	224	7.5	-4.6	-38.6	-52.5	-41.3
Indonesia	295	20.5	4.8	-36.0	-51.2	-31.8
Japan	1,851	10.6	-8.9	-26.1	-33.0	-45.1
Korea	193	27.1	3.0	-32.0	-46.4	-43.4
Malaysia	225	-0.7	-1.4	-18.3	-36.3	-33.0
Philippines	172	4.2	2.3	-23.5	-40.0	-39.4
Singapore	272	6.3	-6.4	-36.5	-48.2	-47.6
Taiwan	166	20.4	14.9	-22.7	-49.0	-39.0
Thailand	128	4.3	-2.1	-32.5	-52.4	-34.8

Source: HSBC

By Asia Pacific sector

Asia Pac Sectors	Current level	1M	3M	6M	12M	24M
Energy	350	16.2	9.6	-29.5	-37.0	-18.9
Consumer Discretionary	94	11.5	6.1	-27.9	-38.5	-47.0
Automobiles & Components	122	8.0	13.8	-28.5	-36.5	-47.6
Consumer Durables & Apparel	76	21.1	7.7	-29.6	-41.9	-48.0
Consumer Services	100	5.2	-7.6	-24.2	-43.7	-50.9
Media	73	4.8	-19.1	-33.5	-43.6	-48.1
Retailing	81	15.3	-8.4	-21.5	-36.0	-41.0
Consumer Staples	103	3.7	-14.8	-25.2	-33.1	-31.9
Food & Staples Retailing	136	4.1	-12.8	-28.0	-32.1	-36.1
Food, Beverage & Tobacco	108	3.9	-13.7	-23.8	-35.8	-31.4
Household & Personal Products	108	2.2	-22.8	-22.5	-24.7	-21.7
Financials	99	18.4	-5.4	-33.3	-42.7	-50.5
Banks	91	18.1	-2.9	-33.4	-41.5	-49.2
Diversified Financials	81	27.8	-12.3	-41.9	-54.5	-61.1
Insurance	112	16.3	-4.6	-28.6	-33.7	-37.3
Real Estate	103	17.2	-9.4	-32.0	-44.8	-55.2
Health Care	128	-1.8	-18.5	-26.7	-25.1	-32.5
Health Care Equipment & Services	143	14.3	-11.9	-32.5	-35.8	-34.0
Pharmaceuticals, Biotechnology & Life Sciences	125	-4.3	-19.6	-25.6	-22.8	-32.4
Industrials	105	14.6	-3.7	-28.4	-41.1	-43.6
Capital Goods	117	17.5	2.0	-29.3	-42.6	-44.5
Commercial Services & Supplies	57	20.6	-14.0	-26.7	-38.3	-43.2
Transportation	107	7.7	-13.1	-26.5	-37.3	-40.9
Information Technology	102	20.3	7.0	-25.5	-39.2	-43.1
Software & Services	134	15.1	-11.0	-27.8	-37.6	-29.1
Technology Hardware & Equipment	95	19.6	8.0	-28.3	-40.1	-46.2
Semiconductors & Semiconductor Equipment	115	25.2	20.5	-18.3	-38.6	-44.5
Materials	182	19.9	6.7	-29.6	-42.1	-42.0
Telecommunication Services	59	-0.8	-14.1	-19.3	-31.7	-26.9
Utilities	122	-3.1	-14.2	-7.0	-14.0	-26.3

Source: HSBC, Datastream

Local indices performance (%)

By country

Countries	Current level	1M	3M	6M	12M	24M
Australia (S&P/ASX 200)	3,580	7.5	-0.1	-28.1	-30.2	-39.9
China (Hand Seng China Enterprise)	8,063	14.1	4.9	-17.2	-25.6	-15.0
Hong Kong (Hang Seng)	13,910	8.7	-1.9	-26.6	-34.1	-29.4
India (Sensex)	9,471	7.4	-1.0	-30.8	-38.1	-28.7
Indonesia (Jakarta Composite)	1,436	10.8	7.4	-23.8	-38.6	-20.5
Japan (TOPIX)	813	11.3	-1.7	-30.4	-33.6	-53.3
Korea (KOSPI)	1,222	14.8	8.3	-18.3	-26.2	-15.6
Malaysia (KLCI)	878	-1.8	1.0	-14.6	-26.9	-29.0
Philippines (PSEi)	1,918	2.6	2.4	-23.6	-33.1	-39.5
Singapore (STI)	1,706	5.7	-1.8	-31.1	-41.7	-45.7
Taiwan (Taiwan SE Weighted)	5,242	18.3	18.5	-14.5	-40.9	-33.3
Thailand (SET)	438	1.6	-0.2	-29.4	-45.7	-35.4

Source: HSBC, Datastream

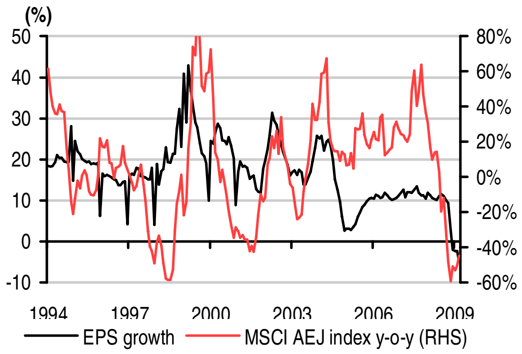
By Asia ex Japan sectors

Asia Ex Japan Sectors	Current level	1M	3M	6M	12M	24M
Energy	426	14.4	7.7	-30.4	-43.3	-18.8
Consumer Discretionary	204	17.7	11.3	-24.7	-41.9	-39.5
Automobiles & Components	174	27.2	26.7	-26.9	-37.6	-35.0
Consumer Durables & Apparel	279	31.2	14.8	-28.0	-41.7	-34.7
Consumer Services	93	10.1	-2.3	-28.3	-50.5	-58.0
Media	67	1.0	-18.3	-45.5	-56.4	-58.3
Retailing	166	14.7	10.5	-21.4	-44.4	-43.0
Consumer Staples	193	4.5	-4.2	-18.6	-35.8	-22.9
Food & Staples Retailing	281	5.0	2.8	-30.8	-41.7	-35.0
Food, Beverage & Tobacco	155	2.9	-3.7	-18.8	-35.8	-28.6
Household & Personal Products	1,124	9.5	2.5	-5.9	-5.2	5.0
Financials	162	14.9	-1.3	-27.7	-42.2	-39.5
Banks	121	18.4	2.2	-33.6	-42.4	-46.5
Diversified Financials	189	26.2	1.0	-27.5	-47.2	-43.8
Insurance	103	15.1	-3.3	-28.9	-35.3	-37.5
Real Estate	96	17.1	-3.1	-30.7	-46.0	-51.6
Health Care	245	2.6	-12.9	-38.8	-46.5	-37.6
Health Care Equipment & Services	133	-2.4	-15.0	-33.7	-43.1	-42.3
Pharmaceuticals, Biotechnology & Life Sciences	626	-10.6	-7.7	-33.1	-38.4	-9.2
Industrials	107	14.1	2.6	-30.8	-50.4	-41.0
Capital Goods	92	16.2	3.2	-32.1	-50.9	-41.8
Commercial Services & Supplies	39	27.7	-17.7	-41.3	-52.2	-60.3
Transportation	129	14.2	-2.2	-33.2	-49.6	-50.3
Information Technology	137	22.4	18.9	-23.9	-42.6	-43.6
Software & Services	111	29.7	20.8	-5.6	-14.3	-6.0
Technology Hardware & Equipment	106	19.7	21.9	-32.3	-50.1	-46.3
Semiconductors & Semiconductor Equipment	134	25.7	20.2	-17.3	-39.0	-41.7
Materials	205	22.7	10.9	-24.5	-49.7	-34.0
Telecommunication Services	99	3.4	-6.5	-20.0	-36.2	-17.9
Utilities	138	3.3	1.8	-15.7	-23.8	-17.2

Source: HSBC, Datastream

Earnings

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



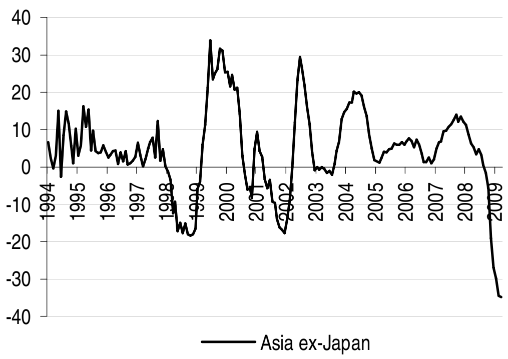
Source: Bloomberg, I/B/E/S, HSBC

2. Consensus forecast for EPS growth

	2008	2009	2010
Australia	-9.6	-7.1	9.0
China	-4.9	1.4	17.6
Hong Kong	-36.2	-17.6	10.4
India	-10.5	3.6	15.7
Indonesia	8.7	-6.6	9.1
Japan	-68.3	-11.8	88.5
Korea	-34.5	-0.2	48.5
Malaysia	-14.9	-16.8	10.4
Philippines	-9.3	7.4	11.1
Singapore	-12.1	-23.0	13.8
Taiwan	-53.6	-59.2	195.3
Thailand	50.9	4.9	15.4
Asia ex-Japan	-26.1	-11.4	30.7
Asia Pacific	-58.8	18.4	40.1

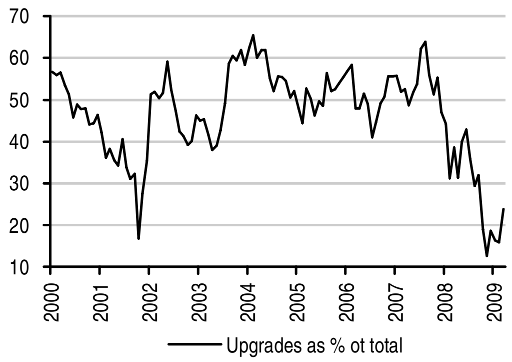
Source: I/B/E/S, HSBC

3. Earnings momentum – Asia ex Japan



Source: I/B/E/S, HSBC

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



Source: I/B/E/S, HSBC

5. Revisions to 2009 EPS forecasts by country

Country	vs 3M ago	Rank	vs 6M ago	Rank
PH	-5.9%	1	-18.3%	1
MY	-10.2%	2	-25.8%	2
ID	-11.8%	3	-32.1%	6
CN	-13.4%	4	-29.4%	3
HK	-13.5%	5	-33.2%	7
IN	-15.4%	6	-29.7%	4
AU	-15.8%	7	-29.9%	5
TH	-16.5%	8	-34.6%	8
SG	-17.2%	9	-36.3%	9
KR	-24.3%	10	-44.1%	10
TW	-47.6%	11	-78.7%	11
JP	-87.4%	12	-90.1%	12
AEJ	-20.9%		-44.8%	
AP	-39.2%		-55.1%	

Source: I/B/E/S, HSBC

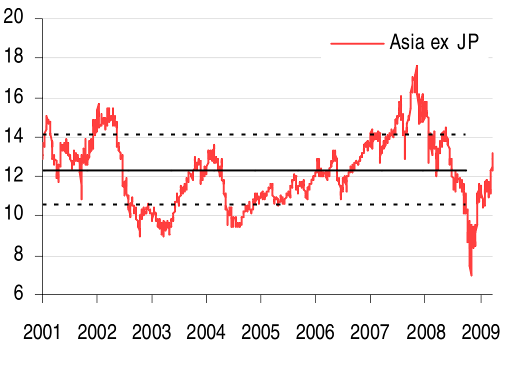
6. Revisions to 2009 EPS forecasts for Asia Pacific sectors

Sector	vs 3M ago	Rank	vs 6M ago	Rank
Telco	-7.6%	1	-9.2%	2
Cons. stap	-13.2%	2	-18.2%	4
Health care	-14.6%	3	-10.9%	3
Utilities	-20.2%	4	3.8%	1
Financials	-22.2%	5	-38.6%	5
Energy	-22.4%	6	-39.9%	6
Industrials	-44.8%	7	-58.1%	7
Materials	-49.1%	8	-68.0%	8
IT	-85.1%	9	-92.4%	9
Cons. discr	-95.6%	10	-97.5%	10
Asia Pac	-39.2%		-55.1%	

Source: I/B/E/S, HSBC

Valuation

1. 12-month forward PE – Asia ex Japan



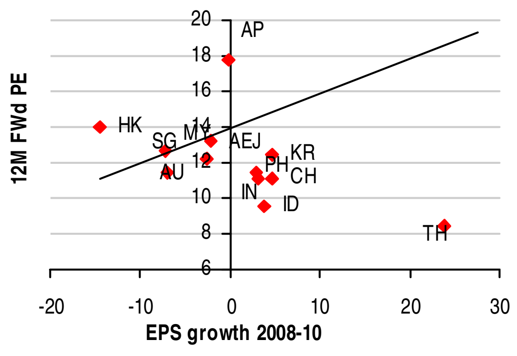
Source: Bloomberg. I/B/E/S, HSBC

2. Current forward PE versus historical average

	PE now	Average 2001–	% diff	Average 1993–	% diff
China	11.1	12.8	-13%	13.1	-15%
HK	14.0	15.8	-11%	14.8	-5%
India	11.4	13.7	-17%	13.5	-16%
Indonesia	9.6	9.0	6%	12.7	-25%
Korea	12.4	9.0	38%	11.2	11%
Malaysia	12.7	14.0	-9%	16.1	-21%
Philippines	11.1	13.9	-20%	14.8	-25%
Singapore	11.4	14.8	-23%	16.4	-30%
Taiwan	30.5	13.8	121%	18.2	68%
Thailand	8.4	10.4	-19%	20.8	-60%
Japan	27.1	18.9	43%	31.3	-13%
Australia	12.2	14.4	-15%	14.9	-18%
Asia ex-Japan	**13.2**	**12.3**	**7%**	**14.5**	**-9%**
Asia Pacific	**17.8**	**15.9**	**12%**	**25.6**	**-30%**

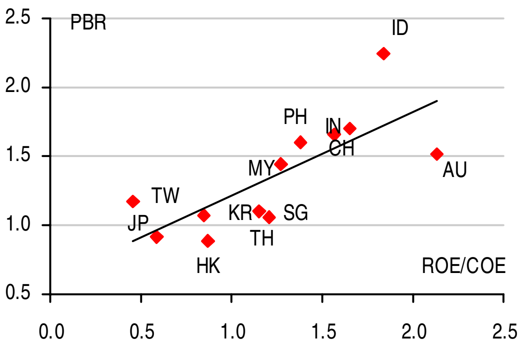
Source: Bloomberg, I/B/E/S, HSBC

3. PE versus average EPS growth 2007-09



Source: I/B/E/S, HSBC

4. PB versus ROE/ COE



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

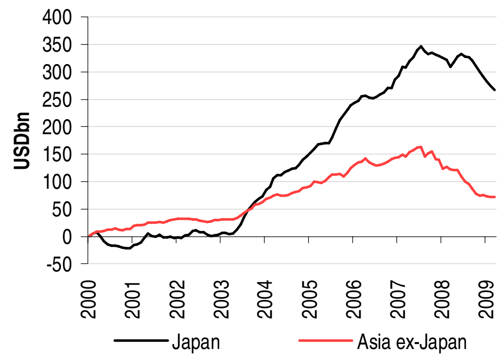
5. Dividend discount model

	AU	CH	HK	ID	IN	JP	KR	MY	PH	SG	TH	TW
Inputs												
DPS year1	42.8	1.3	252.1	92.4	8.3	11.3	1.5	14.0	20.7	43.9	9.6	8.0
EPS year 1	60.8	3.7	507.8	213.7	35.3	18.5	27.1	26.9	35.8	88.0	22.2	6.2
EPS year 2	70.6	4.3	562.4	230.0	41.6	31.7	37.9	29.6	38.9	98.6	25.5	14.3
Growth in stage 2 (%)	7	13	6	15	12	6	8	9	10	9	10	6
No. of years of excess growth	10	12	10	15	15	10	10	10	10	10	10	10
Perpetual growth rate (%)	6.0	6.0	6.0	6.0	6.0	5.0	6.0	6.0	6.0	6.0	6.0	6.0
Payout ratio now (%)	70.3	35.7	49.7	43.2	23.5	61.1	5.5	52.0	57.7	49.8	43.1	129.6
Payout ratio at end stage 2 (%)	50.0	40.0	50.0	45.0	40.0	40.0	40.0	50.0	45.0	50.0	45.0	50.0
COE (%)	8.0	10.2	8.2	14.2	9.7	7.2	10.7	9.2	10.2	8.2	11.7	8.7
Result												
MSCI index now	763	43	6,717	2,084	391	510	342	332	420	984	183	196
Fair value	1,783.7	78.0	10,830.2	2,648.6	823.2	677.9	276.7	536.4	576.3	2,573.7	251.2	301.2
Under/over valued (%)	-57.2	-44.8	-38.0	-21.3	-52.5	-24.8	23.7	-38.2	-27.1	-61.8	-27.1	-35.0

Source: HSBC

Supply & demand

1. Cumulative net buying by foreign investors since 2000



Source: Bloomberg, HSBC

2. Foreign net buying by markets 2008-09

(USDbn)	JP	TW	KR	TH	IN	ID
Feb-08	-3.5	3.1	-2.1	1.0	1.2	0.2
Mar-08	-13.0	-0.6	-3.1	-0.3	0.0	-0.3
Apr-08	8.0	-1.0	-1.2	0.0	0.2	0.2
May-08	10.8	0.4	0.9	0.0	-1.1	0.4
Jun-08	4.5	-3.8	-4.6	-1.1	-2.5	0.0
Jul-08	-4.6	-3.6	-4.8	-1.1	-0.2	-0.1
Aug-08	-1.5	-0.7	-2.8	-0.3	-0.5	0.0
Sep-08	-5.4	-2.8	-2.4	-0.8	-1.7	0.3
Oct-08	-10.6	-3.5	-3.4	-0.5	-2.9	0.4
Nov-08	-10.8	-1.7	-1.2	-0.3	-0.7	0.5
Dec-08	-8.3	0.5	0.6	-0.3	0.3	0.1
2008	**-37.6**	**-14.7**	**-33.3**	**-4.9**	**-12.2**	**1.7**
Jan-09	-9.4	-1.6	0.6	-0.1	-0.9	-0.1
Feb-09	-7.9	-0.4	-0.6	-0.1	-0.5	0.0
Mar-09	-7.4	0.3	0.0	0.0	0.0	0.1

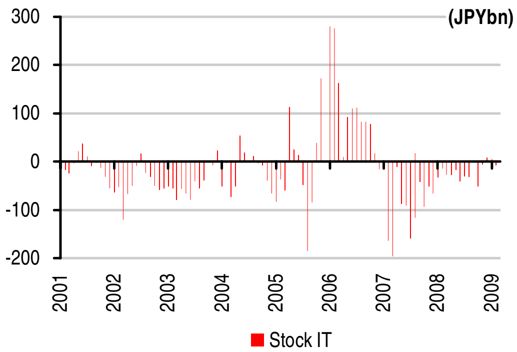
Source: Bloomberg, HSBC

3. Total equity issuance by market 2006-09

(USDbn)	2006	2007	2008	2009	2009* v 2008
AU	30.8	23.3	26.7	4.4	-29%
CH	69.0	53.1	12.8	6.2	107%
HK	20.2	20.7	4.6	0.1	-91%
IN	12.2	24.3	10.6	0.1	-98%
JP	56.6	19.5	11.1	3.6	38%
KR	11.3	10.1	3.0	1.3	91%
MY	1.1	3.1	0.6	0.1	-14%
SG	5.2	6.1	0.8	0.2	12%
TH	2.9	0.6	0.6	0.0	-91%
TW	6.1	8.9	1.4	0.2	-52%
AEJ	**132.1**	**158.0**	**64.7**	**12.7**	**-16%**
AP	**219.6**	**177.6**	**75.8**	**16.2**	**-8%**

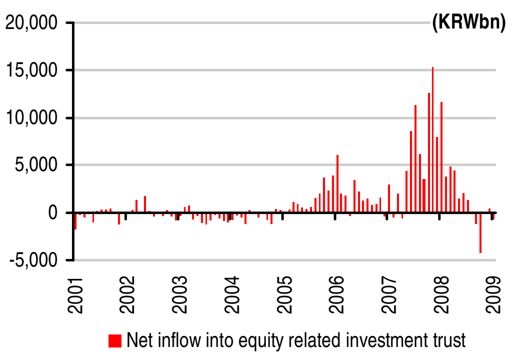
Notes: 2009 Y-t-d data up to 24 Mar 2009' * = annualized
Source: Bloomberg, HSBC

4. Net inflows into Japanese equity investment trusts



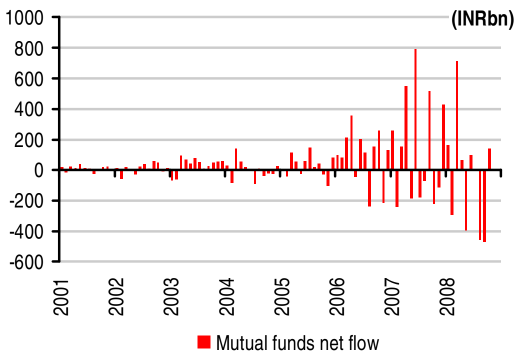
Source: IT association, HSBC

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



Source: CEIC, HSBC

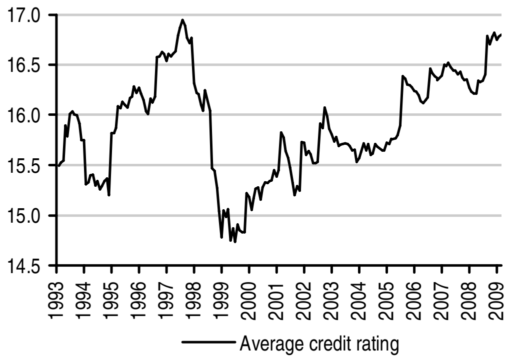
6. Net inflows into Indian mutual funds



Source: CEIC, HSBC

Politics and risk

1. Average sovereign credit rating – Asia ex Japan



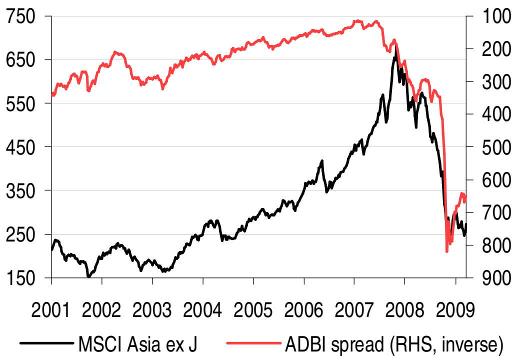
Source: Bloomberg. HSBC

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

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

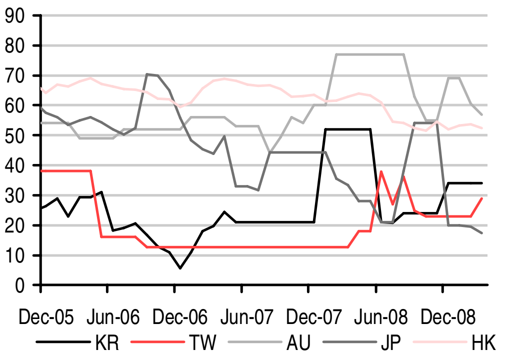
Source: Bloomberg

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



Source: I/B/E/S, HSBC

4. Government approval ratings



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

5. Political snapshot of Asia Pacific markets

Country	Head of government	Latest approval rating	Next significant political events	Consensus view of result
Australia	Kevin Rudd (PM)	57%	Federal Election to be held by 2010	
China	Hu Jintao (President)	-	Next Presidential election by mid – March 2013	
Hong Kong	Donald Tsang (Chief Executive)	52%	Next Chief Executive election to be held in 2012	
India	Manmohan Singh (Prime Minister)	-	Parliamentary elections to be held from 16 Apr 2009	UPA likely to win
Indonesia	Susilo Bambang Yudhoyono (President)	47%	Parliamentary election to be held on 9 Apr 2009	Ruling Democrat Party the favourite
Japan	Taro Aso (PM)	17%	House of Reps. elections by Sept 09	LDP to win majority
Korea	Lee Myung bak	34%	Presidential election to be held in 2012	
Malaysia	Abdullah Ahmad Badawi (PM)	46%	Deputy PM Najib Razak to be PM inApr09	
Philippines	Gloria Macapagal-Arroyo (President)	26%	Presidential election by May 2010	Unclear
Singapore	Lee Hsien Loong (PM)	-	Presidential election by 2011	Ruling People's Action Party the favourite
Taiwan	Ma Ying-jeou (President)	29%	Presidential election by 2012	
Thailand	Abhisit Wetchachiwa (PM)	51%	Parliamentary elections to be held in 2011	

Source: Various polling agencies and media, HSBC

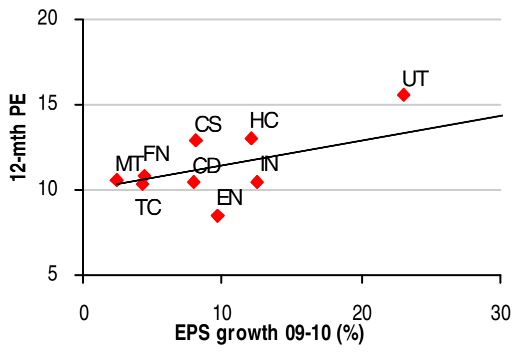
Sectors and stocks

2. MSCI Asia-Pacific sector performance (Q1-2009)

%	3M	Y-t-d	3M relative	Y-t-d relative	Weight*
Energy	9.6	3.9	12.6	10.3	4.6
Information Technology	7.0	3.6	10.0	9.9	12.3
Materials	6.7	1.4	9.7	7.8	9.6
Consumer durables	6.1	1.7	9.1	8.0	12.2
Industrials	-3.7	-7.9	-0.7	-1.6	13.6
Financials	-5.4	-8.2	-2.3	-1.8	24.1
Telecom	-14.1	-16.6	-11.1	-10.2	6.6
Utilities	-14.2	-15.3	-11.2	-9.0	6.5
Consumer staples	-14.8	-16.6	-11.8	-10.2	6.2
Health Care	-18.5	-20.6	-15.5	-14.3	4.3
MSCI Asia-Pacific	**-3.0**	**-6.3**			

Notes: * = in MSCI Asia Pacific; 3M and Y-t-d data up to 24 Mar 2009
Source: Bloomberg, HSBC

3. PE vs 2009-10 growth, Asia ex-Japan sectors



Source: I/B/E/S, HSBC.
Note: IT sector not depicted here and has Fwd PE= 38.5 & Avg growth for 09-10=197.8%

4. Consensus EPS growth (%) by sector

	Asia Pacific		Asia ex-Japan	
	2009	2010	2009	2010
Consumer disc	1238.5	1402.4	-4.1	20.1
Technology	409.6	572.9	-75.1	470.7
Utilities	232.4	0.2	26.2	19.8
Health Care	158.1	7.9	7.8	16.4
Financials	41.5	17.9	-9.0	17.9
Energy	34.4	23.1	-3.3	22.8
Consumer staples	8.6	8.3	1.8	14.5
Telecoms	3.9	5.4	3.4	5.1
Industrials	-22.6	37.9	3.9	21.1
Materials	-23.1	40.3	-21.4	26.4

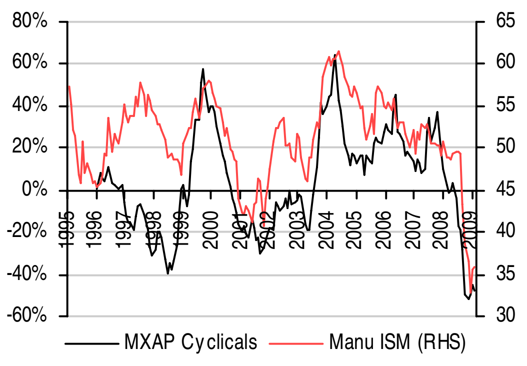
Source: I/B/E/S

5. Consensus PE (x)

	Asia Pacific		Asia ex-Japan	
	2009	2010	2009	2010
Consumer disc	297.5	19.8	11.0	9.2
Technology	119.7	17.8	82.3	14.4
Materials	17.3	12.4	11.1	8.8
Utilities	16.4	16.4	16.4	13.7
Industrials	15.2	11.0	11.0	9.1
Consumer staples	14.5	13.4	13.5	11.8
Health Care	13.2	12.2	13.3	11.4
Financials	11.8	10.0	11.3	9.6
Energy	10.4	8.4	8.9	7.2
Telecoms	10.0	9.5	10.5	10.0

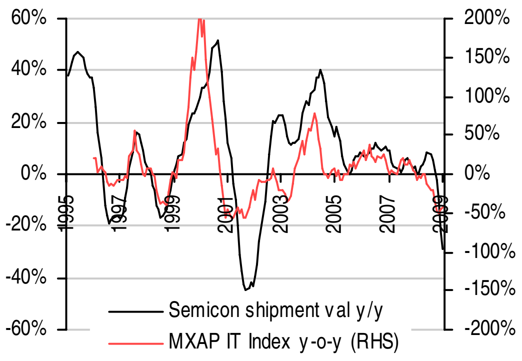
Source: I/B/E/S

6. MSCI Asia Pacific cyclical sectors vs Manufacturing ISM index



Source: HSBC, Bloomberg

7. Semiconductor shipment vs MSC Asia Pacific IT sector



Source: WSTS, Bloomberg

Scorecards

8. Asia ex-Japan

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

Source: HSBC

9. Australia

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

Source: HSBC

10. China

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

Source: HSBC

11. Hong Kong

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

Source: HSBC

12. India

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

Source: HSBC

13. Japan

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

Source: HSBC

HSBC

14. Korea

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

Source: HSBC

15. Singapore

	Price momentum			Earnings momentum			Valuation			Consolidated		
	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg	Now	1M chg	3M chg
Consumer Staples	1	1	2	1	0	0	5	0	1	1	0	4
Industrials	3	2	1	3	-1	0	2	1	0	2	1	0
Telecommunication Services	2	-1	-1	2	1	5	4	0	3	2	-1	4
Health Care	5	0	-1	3	2	0	1	0	0	4	1	-3
Financials	6	-2	-2	5	1	-2	3	-1	-1	5	1	-3
Consumer Discretionary	4	-2	-2	6	-3	-4	5	0	0	6	-3	-4

Source: HSBC

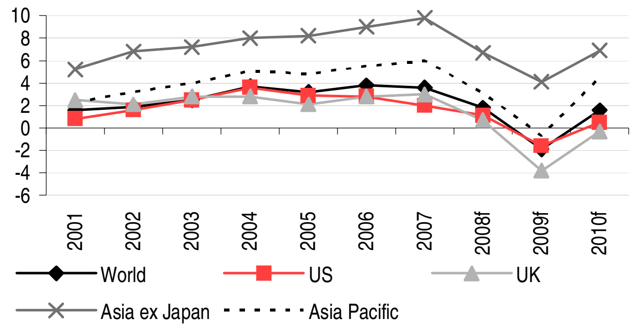
16. Taiwan

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

Source: HSBC

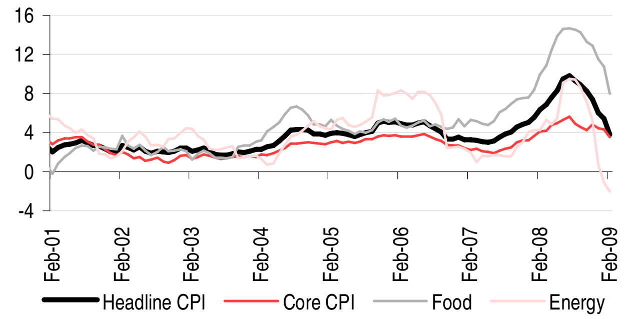
Economic forecasts

1. GDP growth (%)



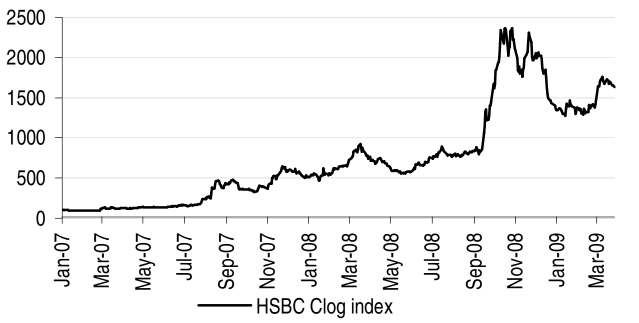
Source: HSBC

2. Asia ex Japan CPI breakdown



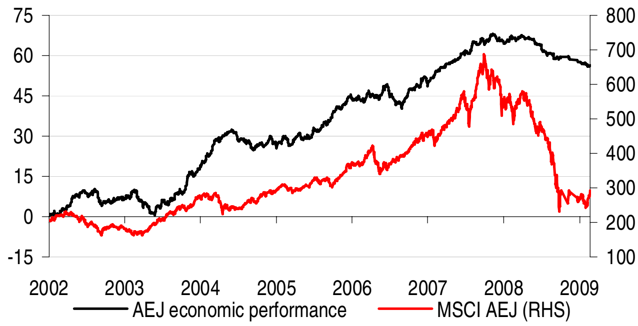
Source: HSBC

3. HSBC Clog index



Source: HSBC

4. Leading eco indicators for Asia ex Japan



Source: HSBC

HSBC Economic Forecasts

	Real GDP (% yr)		CPI (avg, % yr)		Exchange rate (avg, %)		Long rates (avg, %)		Short rates (avg, %)	
	2009f	2010f	2009f	2010f	2009f	2010f	2009f	2010f	2009f	2010f
Australia	0.1	3.1	2.1	2.5	0.70	0.72	5.9	6.0	4.6	4.7
China	7.8	8.5	-0.2	0.8	6.80	6.80	5.0	5.0	1.1	1.0
Hong Kong	-4.5	2.4	1.6	1.0	7.80	7.80	1.6	1.6	0.8	0.6
India	6.2	8.0	6.9	4.7	54.0	54.0	7.0	7.3	6.7	6.0
Indonesia	2.5	2.5	5.8	8.0	13,500	13,500	11.8	12.3	8.7	7.2
Japan	-6.5	1.6	-1.4	-1.0	105	105	1.4	1.5	0.4	0.4
Korea	-3.7	3.4	3.2	3.2	1,200	1,200	5.0	5.8	2.3	2.2
Malaysia	-3.5	5.5	0.9	2.8	4.00	4.10	4.4	4.4	1.7	1.4
Philippines	1.0	3.0	4.3	4.5	53.0	53.0	9.3	9.3	5.1	6.0
Singapore	-7.0	4.5	0.4	1.9	1.64	1.64	2.0	2.0	0.7	0.9
Taiwan	-6.2	2.2	-1.3	-0.4	36.0	36.0	2.0	2.5	0.5	0.6
Thailand	-3.5	3.0	-1.4	2.7	38.5	38.5	4.3	4.5	1.5	1.2
Vietnam	4.5	6.5	7.4	9.3	18200	18200				
Asia Ex Japan	3.8	6.6	2.0	2.4						
Asia Pacific	-0.7	4.5	0.6	1.1						

Source: HSBC

Top stock picks

HSBC

AU Optronics, 2409, OW(V)

- LCD sector is on track to enter a new upcycle
- AUO has stronger recovery momentum than peers
- We have an Overweight (V) rating and TWD37.8 target price

The LCD industry appears to be entering a new upcycle with continued panel price recovery and we believe the improving industry outlook will be the main share price catalyst for AUO. We think most of the negative news is already priced in and that the risk/reward is favourable for AUO.

We expect a supply shortage in LCD panels to emerge from 3Q09. We do not share the market's concern that demand will fall sharply from late 2Q. Conversely, we expect to see intensive re-stocking demand from late 2Q09 in preparation for peak season sales, which should stimulate faster panel price recovery.

We believe AUO has stronger recovery momentum than peers, mainly because it has more room to improve in terms of capacity utilization (by comparison, LGD's utilization rate was around 90% in February whereas AUO's was only 60%). During our recent marketing trip (mid-February to mid-March), we found much interest in LCD names, but investors are reluctant to commit given the poor macro outlook. We believe continued improvement in visibility will remove investors' concerns and catalyse another run of market re-ratings of the LCD names. AUO is our top pure panel maker pick.

Valuation. Although the outlook for the LCD industry is improving, in order to reflect the slowdown in the global economy we use AUO's trough valuation to set a target price. We apply a target PB multiple of 1.0x (trough PB since 2005). Our target price of TWD37.8 implies a potential total return (including dividend yield) of 35%; we rate the stock Overweight (V).

Risks. The main downside risks to our view are a weaker than expected recovery in LCD panel demand, which would make the current panel price recovery short-lived.

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Key financials & valuation

Share price: (TWD)28.05 — **Market cap:** (TWDm)238,585

Year to	Net sales (TWDm)	HSBC EBIT (TWDm)	HSBC net profit (TWDm)	HSBC EPS (TWD)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
12/2007a	480,184	63,275	56,418	6.75	473.4	4.2	8.9	21.2	0.8
12/2008e	423,928	30,593	21,269	2.50	-62.9	11.2	1.3	7.1	0.8
12/2009e	323,285	270	-5,753	-0.68	-127.0		0.0	-2.0	0.8
12/2010e	465,836	38,266	30,091	3.54		7.9	3.8	9.9	0.7

Notes: price at close of 31 Mar 2009. * = Based on HSBC EPS (fully diluted). Source: HSBC

HSBC

Bank of China, 3988, OW(V)

- Profit "protection": Least sensitive to rate cuts of H-share banks; revenue sources perhaps more diversified through the cycle
- Overhangs reduced: Toxic assets/FX investments greatly reduced and recent blocks have removed large share overhang threats
- We have an Overweight (V) rating and HKD3.00 target price

NIM better protected. NIM declined 6bps q-o-q in 4Q, much smaller than peers (14bps at ICBC, 23bps at CCB, and 60bps at BoCOM). We believe BOC is most defensive to rate cuts as 29% of loans and 37% of investments are in foreign currency, thus not directly affected by PBOC rate cuts.

More diversified revenue. Net interest income accounts for c70% of operating income, the lowest among Chinese banks. As a result, revenue is more diversified and protected.

Toxic assets and FX investments cut. Toxic assets were reduced to USD7.25bn at end-2008, or 32% below 2Q08. FX investments were cut 11% y-o-y to RMB615bn, accounting for 37% of total investment (vs. 43% at end-07). We expect much lower impairment charges on FX investment in 2009.

Share overhang reduced: 13.9% of shares that were held by strategic investors saw lock-up expiry in December 2008. UBS, Li Ka-shing and RBS Group sold an aggregate 6.4% of BOC shares in January 2009. This brings down the percentage of shares subject to strategic shareholder sell-down to 7.5%.

Low volatility compared to peers. This is a plus in a down-cycle and markets may become more sentiment driven.

Valuation. Even with the recent price rally, BOC's valuation is still attractive compared to other SOE banks. BOC is trading at 1.2x 2009e book value vs BoCOM at 1.5x, CCB and ICBC each at 1.9x. Our target price is HKD3.00 for the H-share, based on sum-of-the-parts valuation.

Risks. Major upside (and downside) risks include a) higher/ (lower) NIM due to smaller / bigger than expected rate cuts; b) better/ (worse) asset quality; c) lower/(higher) fx and sub-prime related losses.

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Key financials & valuation

Share price: (HKD) 2.57 — **Market cap:** (USDbn) 84

Year to	HSBC NAV	HSBC PBT	HSBC net profit	HSBC EPS	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
	RMBm			RMB					
12/2008a	1.83	87,197	64,360	0.25	14	8.9	5.8	14.5	1.2
12/2009e	1.93	74,185	57,728	0.23	-10	9.9	4.5	12.1	1.2
12/2010e	2.10	91,370	70,964	0.28	23	8.1	5.6	13.9	1.1

Notes: price at close of 31 Mar 2009. * = Based on HSBC EPS (fully diluted). Source: HSBC estimates

HSBC

China Agri, 606, OW(V)

- A leading agri player with compelling valuation; trades at unjustified c60% discount to peers on 09e PE and PB
- We expect 25% net profit CAGR over the next two years
- We have an Overweight (V) rating and HKD5.5 target price

Earnings outlook strong. Given the government's strong support for the agriculture industry in China, we believe China Agri is on track to deliver a net profit CAGR of 25%, gross margin of c11% and net margin of c5-6% over the next two years.

Healthy balance sheet eases liquidity concerns. Due to rising operating cash flow, we expect China Agri's gearing to stay at 23% in 2008 and c10% in 2009-10. We forecast interest coverage to rise from 3.6x in 2007 to 9x in 2010.

Valuation. China Agri is trading at 6.8x 2009e PE and 0.9x 2009e PB, approximately 60% discounts to domestic food processing peers. Given its higher growth and returns, we do not believe such a discount is justifiable. Should China's economic growth beat consensus and/or crude oil rebound in 1H09, China Agri has a better chance of rallying than other F&B plays.

We regard a sum-of-the-parts (SOTP) analysis as the most suitable methodology to value China Agri since agricultural processing is a relatively conventional sector, whereas bio-fuel and bio-chem are emerging businesses with different dynamics. We rate the stock Overweight (V) with a HKD5.5 target price.

Risks. Sharp pullback of agri-commodity prices; removal of bio-fuel licensing scheme and removal of bio-fuel subsidy policy; project delays; hostile weather conditions.

Catalysts. Earnings results release in April 2009; potential acquisitions of oil crushing/refining businesses and bio-fuel/bio-chem businesses; ppotential asset injection from parent company, COFCO; rebound of agri-commodity prices.

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Key financials & valuation

Share price: (HKD) 3.7 — **Market cap:** (USDm) 1,723

Year to	Net sales (HKDm)	HSBC EBIT (HKDm)	HSBC net profit (HKDm)	HSBC EPS (HKD)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
2007	28,869	1,152	1,100	0.32	19	16	-	13.4	1.5
2008e	42,298	4,308	3,274	0.91	183	4.3	5.8	28.2	1.0
2009e	34,652	2,584	2,043	0.57	-38	6.9	4.4	15.1	0.9
2010e	39,429	2,904	2,288	0.64	12	6.1	4.9	15.2	0.8

Notes: price at close of 2 April 2009. * = Based on HSBC EPS (fully diluted). Source: HSBC estimates

China BlueChemical, 3983, OW(V)

- Key beneficiary of price cap removal. Benefits from higher product prices through backward integration
- Phosphate assets acquired from CNOOC to drive earnings growth in 2009 onwards
- We have an Overweight (V) rating and HKD5.65 target price

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For 2008, China BlueChemical reported net profit of RMB1,635m and EPS of RMB0.35, up 13% y-o-y. Although the full year results showed decent growth, 2H08 net profit was down 31% HoH due to lower urea sales and product prices. However, we expect strong growth in 2009 due to asset acquisition from the parent and price cap removal.

Despite an oversupply of phosphate fertiliser in China, we expect the integrated phosphate asset acquired by China BlueChemical from the parent to become the earnings driver in 2009. We forecast integrated phosphate fertiliser gross margin to improve to 19% in 2009 with the sulphur price stabilising.

A strong urea price after pricing reform will further strengthen earnings in 2009. The current domestic urea ex-factory price is RMB1,800/ton, higher than the removed price cap of RMB1,725/ton. As Bluechem's gas cost is relatively flat, for every 10% increase in urea price over our conservative 2009 price assumption of RMB1,650/ton, the company's net income will improve by 15.6%.

Valuation. We value the company by applying a PE multiple of 13x, ie the average PE of integrated nitrogen and phosphate producers in China, to our 2009e earnings estimate (RMB0.38/share).

Key risks are gas supply interruption, unfavourable changes in government pricing policy, and lower than expected product demand.

Key financials & valuation

Share price: (HKD) 4.22 — **Market cap:** (HKDm) 19,454.2

Year to	Net sales (RMBm)	HSBC EBIT (RMBm)	HSBC net profit (RMBm)	HSBC EPS (RMB)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
12/2007a	4,340	1,443	1,448	0.31	-52.0%	13.2	1.93%	19.60%	2.4
12/2008a	5,518	1,876	1,635	0.35	13.0%	10.6	1.84%	19.00%	1.8
12/2009e	6,031	1,976	1,752	0.38	11.5%	9.2	2.16%	17.40%	1.5
12/2010e	6,614	2,332	1,917	0.42	9.4%	8.4	2.37%	16.70%	1.3

Notes: price at close of 31 Mar 2009. * = Based on HSBC EPS (fully diluted). Source: Company data, HSBC estimates

HSBC

CCC, 1800, OW(V)

- CCC is being firmly re-rated as order flow picks up again
- We expect 09-12e EPS CAGR of 20.1%. Catalysts: order flow for ports & roads to accelerate; little FX loss
- We have an Overweight (V) rating and HKD11.74 target price

China Communications Construction (CCC) is one of China's largest transportation infrastructure construction companies, dominating the high margin port construction business. It has been aggressively moving into the large volume domestic railway construction market.

We think CCC deserves its re-rating on massive orders arising from the government's mammoth fiscal pump-priming since last November. New orders received in 4Q08 already exceeded the previous 6 months, and this momentum has been sustained into 2009 with the total for the first two months reaching over half the sum for 1Q08. As well as the expected jump in railway contracts, CCC has also seen a pick up in port construction and road and bridge contracts. The latter typically take longer to be approved; hence we take this as a very positive trend. This should be reflected in Cocks' order flow from 2Q09 onwards.

In addition, we believe CCC has been tightening its practices on fore contracts, after its substantial loss in 1H08. We think the turning around of its FX loss into profit in November is a sign of effective control starting to be in place.

Valuation. We expect CCC's earnings momentum to re-accelerate to a 20.1% earnings CAGR between 2009-12e. CCC's net margin is the highest among its China infrastructure construction peers, and this has since translated into the highest RoE as well. At HKD8.5, CCC trades at 12.4x 2009e PE, a 30% discount to listed China construction peers. Our target price based on a mid-cycle PE of 18.7x and DCF is HKD11.74, implying potential return of 39.7%. We rate CCC Overweight (V).

Risks. a) Weak 2H08 results; b) FX loss expansion; and c) delays in project completion and granting of project compensation.

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Key financials & valuation

Share price: (HKD) 8.50 — **Market cap:** (HKDm) 127,946

Year to Dec	Net sales (RMBm)	HSBC EBIT (RMBm)	HSBC net profit (RMBm)	HSBC EPS (RMB)	EPS growth (%)	PE* (x)	Div yield (%)	ROE (%)	PB (x)
12/2007a	150,601	9,100	6,032	0.41	39.5	20.9	1.0	13.4	2.8
12/2008e	186,649	10,741	5,875	0.40	-2.6	18.8	1.1	11.8	2.2
12/2009e	235,365	14,999	8,885	0.60	51.2	12.4	1.6	15.6	1.9
12/2010e	283,448	19,076	10,900	0.74	22.7	10.1	2.0	16.6	1.7

Notes: price at close of 31 Mar 2009. * = Based on HSBC EPS (fully diluted). Source: HSBC estimates

HSBC

Chinatrust, 2891, OW(V)

- Strong profitability and diversified loan book to insulate in the downturn; expect superior ROE
- Well positioned to enter China market should regulations be lifted after cross-Strait MOU discussions in June; most efficient TW bank
- We have an Overweight (V) rating and TWD17.1 target price

Strongest profitability. We expect Chinatrust's superior operating efficiency and diversified loan book to provide stronger earnings and cushion NPL risk in an economic downturn. We estimate average ROE of 8.5% for FY09-10, higher than the average 6.3% of its peers among our coverage.

Advantageous position to enter China market. Being one of the first seven banks with a representative office set-up in China, we believe Chinatrust will be an early mover should regulations be relaxed. The upcoming cross-Strait financial MOU discussion in June is expected to be positive for sentiment for Chinatrust.

Improved CAR to buffer risks in a downturn. Chinatrust FHC's CAR improved to 128.29% (from 110%) at end 2008 and the bank's CAR improved to 12.6% (from 11.6%), a well-capitalized level, in our view, to cope with the tough business environment.

Valuation. Our valuation of Chinatrust FHC is based on sum-of-the-parts. We value the main subsidiaries using PB and ROE based on FY09e book value, with our target PB derived from the (ROE-g)/(k-g) equation, where ROE stands for normalized ROE, g stands for long-term growth rate, and k stands for cost of capital. Our TWD17.1 target price implies a target multiple of 1.26x FY09e book value (TWD13 per share).

Risks. Our OW(V) call on Chinatrust is subject to risks from 1) rising NPLs of its US subsidiary, 2) its 11% holding in Mega shares that is subject to MTM risk, 3) higher-than-expected domestic NPLs, and 4) legal disputes with clients from structured product sales.

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Key financials & valuation

Share price: (TWD) 12.4 — **Market cap:** (TWDbn) 113

Year to	Net sales (TWDm)	HSBC pre-tax (TWDm)	HSBC net profit (TWDm)	HSBC EPS (TWD)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
2007a	NA	13,818	13,339	1.46	NA	8.5	1.5	12.0	0.99
2008e	NA	14,802	14,707	1.50	2.7	8.3	0.0	12.0	0.95
2009e	NA	9,793	9,616	0.94	-37.3	13.2	2.3	7.2	0.89
2010e	NA	13,845	13,594	1.38	46.5	9.0	3.3	9.8	0.82

Notes: price at close of 31 March 2009. * = Based on HSBC EPS (fully diluted). Source: Company data, HSBC estimates

HSBC

CIIH, 966, OW(V)

- Business mix and margin improve at Tai Ping Life
- Growth of new business value is the strongest of our coverage
- We have an Overweight (V) rating and HKD20 target price

The driver for CIIH is Tai Ping Life (TPL), which sells life products in China. Though small (2.6% of market share), growth of new business value is the strongest within our coverage. New business value, which measures profitability of one year's new sales, jumped 43% last year, supported by a shift in business mix and margin expansion. The momentum continues – premiums from wider-margin regular products doubled in Jan-Feb, accounting for 45% of the total, up from 35% in 2008 and 24% in 2007. As the agency force gains in scale and experience, mix and margin should further improve. Management is profit-driven and their background in reinsurance means they keep better control over risks and underwriting.

Valuation. We use sum-of-the-parts to value CIIH as it has operations in life, P&C, pension, reinsurance and asset management. Being a young company, TPL's inforce book is small and the value is driven by growth expectations. The life business is priced at a new business multiple of 21.7x (representing long-term annual growth of 7%) and makes up almost 90% of the target price. We continue to value the P&C unit at zero because of its lack of scale and fundraising needs. The reinsurance arm is valued at 1.3x book. The stock trades at an implied new business multiple of 11x, the lowest within our coverage.

Risks. As the China operations are still expanding, earnings at CIIH will be more volatile than its bigger rivals. Expense overrun at the life company and development costs (not amortized) at the P&C company and pension unit could be a drag on profitability. The ICBC venture is another uncertainty. The proposed alliance will allow CIIH to tap into ICBC's corporate client base. Though the benefits aren't factored in our forecast, the market appears to expect the deal to go through. If it doesn't, due to shareholding structure or pricing, sentiment could suffer.

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Key financials & valuation

Share price: (HKD) 12.46 — **Market cap:** (USDm) 2,285

Year to	Net sales (HKDm)	HSBC EBIT (HKDm)	HSBC net profit (HKDm)	HSBC EPS (HKD)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
2007	17,649	3,217	1,549	1.08	203.3	11.5	0.8	31.4	3.1
2008	24,209	30	(300)	(0.21)	NM	NM	0	-5.8	3.9
2009e	27,080	1,734	533	0.37	NM	33.5	0.3	10.8	3.4
2010e	31,033	2,407	796	0.56	49.4	22.4	0.4	14.1	3.0

Notes: price at close of 31 Mar 2009. * = Based on HSBC EPS (fully diluted). Source: Company data, HSBC estimates

HSBC

Fubon, 2881, OW(V)

- ING Life inclusion to have limited impact on financial performance and capital strength
- Diversified business and strong capital make Fubon more defensive in economic downturn
- We have an Overweight (V) rating and TWD23.6 target price

Life business relatively stable versus peers. We expect the inclusion of ING Life from February to have limited financial impact on Fubon's FY09 financial figures due to ING Taiwan's asset cleanup at end 2008 and its conservative investment portfolio. We believe the acquisition of ING Life is strategically positive to Fubon in the long term for its greater scale.

Improved asset quality at the banking arm. The NPL ratio of Taipei Fubon Bank improved to 0.79% at end 2008 from 1.19% at end 2007, with provision coverage lifted to 75% from 67%; we believe this level is sound versus peers and will buffer against the impact of an upward NPL cycle in the coming quarters.

Diversified business and strong capital. We expect Fubon to stay defensive in a downturn due to its diversified business across banking, insurance and securities. Fubon FHC's CAR improved to 145.7% at end 2008. Despite the RBC calculation for insurance coming to an end in 2009, we expect Fubon's capital to remain strong and the chance of further recapitalization for its insurance arm to be small.

Valuation. Our valuation of Fubon FHC is based on sum-of-the-parts. We value the main subsidiaries using PB and ROE based on FY09e book value, with our target PB derived from the (ROE-g)/(k-g) equation, where ROE stands for normalized ROE, g stands for long-term growth rate, and k stands for cost of capital. Life business is valued using embedded values. Our target price of TWD23.6 implies a target PB multiple of 1.14x FY09e book value (TWD20.9 per share).

Risks. Our OW(V) rating is subject to risks from 1) higher-than-expected NPL formation, 2) low investment yield due to further rate cuts, and 3) a lengthy economic downturn that drags overall business environment further.

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Key financials & valuation

Share price: (TWD) 20.45 — **Market cap:** (TWDbn) 166

Year to	Net sales (TWDm)	HSBC pre-tax (TWDm)	HSBC net profit (TWDm)	HSBC EPS (TWD)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
2007a	NA	14,407	14,432	1.87	71.8	10.9	7.3	8.8	0.94
2008e	NA	10,873	10,810	1.40	-25.1	14.6	0.0	7.0	1.08
2009e	NA	11,538	11,463	1.41	0.7	14.5	3.5	7.4	0.98
2010e	NA	12,274	12,236	1.51	6.7	13.6	5.1	7.1	0.93

Notes: price at close of 31 March 2009. * = Based on HSBC EPS (fully diluted). Source: HSBC estimates

Innolux Display, 3481, OW(V)

- Industry outlook remains positive and recovery in monitor panel prices should accelerate from 2Q09
- No change in our view that Innolux will become profitable from 2Q09, one quarter ahead of pure panel makers
- We have an Overweight (V) rating and TWD43 target price

We believe that from 2Q through year-end, the normal demand cycle will stimulate sales of LCD panels for large TVs and notebook computers. We think this will result in a shortage of supply of LCD panels from 3Q09. Monitor panel prices, the main earnings driver for Innolux, have risen by about 3% in 1Q09 since the end of 2008. We forecast that panel prices will rise 10-15% q-o-q in 2Q and 15-20% q-o-q in 3Q09, driven by the tightening supply-demand balance for LCD panels.

Due to the expected price recovery, better utilization rates, and greater economies of scale, we believe Innolux will reach breakeven in April and become profitable from May. Thus we expect Innolux to return to the black from 2Q09, three months before pure panel makers AUO (2409 TT) and LGD (034220 KS).

Valuation. We believe it is appropriate to value Innolux based on a reasonable PE in an upcycle, as the company's business model is for sustainable profitability and is less cyclical than pure panel makers. We set our target PE multiple for Innolux at 20x 2009e EPS. Although the shares have outperformed the market over the past three months, we believe rising panel prices and growing market share will continue to be catalysts for a market re-rating of the stock over the next 12 months. Our target price of TWD43.0 implies a potential total return (including dividend yield) of 32%; we rate the stock Overweight (V).

Risks. If the magnitude of the supply shortage is greater than we expect, Innolux could face the risk of sourcing inadequate LCD panel supply and jeopardise its business growth.

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Key financials & valuation

Share price: (TWD)33.05 — **Market cap:** (TWDm) 103,238

Year to	Net sales (TWDm)	HSBC EBIT (TWDm)	HSBC net profit (TWDm)	HSBC EPS (TWD)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
12/2007a	157,171	17,078	16,152	6.32	395.7	5.2	4.5	24.6	1.0
12/2008e	160,008	5,966	5,449	1.72	-72.7	19.2	1.3	5.7	1.1
12/2009e	187,629	8,244	6,780	2.15	24.4	15.4	1.6	6.8	1.0
12/2010e	242,978	17,896	15,292	4.84	125.5	6.8	3.7	14.0	0.9

Notes: price at close of 31 Mar 2009. * = Based on HSBC EPS (fully diluted). Source: HSBC estimates

Maanshan, 323, OW(V)

- A major beneficiary of China's fiscal infrastructure stimulus
- Leverage to China's potential undersupply in construction steel
- We have an Overweight (V) rating and HKD3.3 target price

Maanshan will be a major beneficiary of China's RMB4trn stimulus package that will focus on investment in railways, roads, public housing and rural infrastructure, all of which will require construction steel. Long steel (construction steel), which account for nearly half of Maanshan's revenues, should benefit from increasing expenditure on infrastructure activity over the next 12-18 months. The stock is inexpensive relative to its peers.

Catalysts. Confirmation of improved demand for construction steel should be evidenced by declining stock levels over the coming months. After a large loss of Rmb2.3bn in 4Q08, we are looking for a return to profits by late 2Q09, which will be an important indicator of improving market conditions, at least incrementally. An area where Maanshan stands to strongly benefit is in increased investments in railways, where the company is the largest railway wheel producer in China.

Valuation. We reiterate our OW(V) rating on Maanshan for its organic growth and leverage to construction steel. Maanshan should benefit from its recently completed 5mt flat steel plant, together with tight markets for construction steel. We view its valuation as compelling – 0.8x 2009e PB (EV/t of USD364/t), nearly a 50% discount to its regional peers. Our target price of HKD3.3 is based on 0.86x 2008e PB (book value RMB3.35). This multiple is based on a residual income method, i.e., P=BVx(ROE-g)/(CoE-g), assuming our forecast ROE of 10%.

Risks. A more severe slowdown in the US or China would negatively impact steel consumption growth, plus Maanshan's ability to manage costs will be critical given its low margins and high gearing.

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Key financials & valuation

Share price: (HKD) 2.73 — **Market cap:** (USDm) 3,019

Year to Dec	Net sales (RMBm)	HSBC EBIT (RMBm)	HSBC net profit (RMBm)	HSBC EPS (RMB)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
2007	49,053	3,813	2,467	0.35	-5.5%	6.9	5.4%	11.4%	0.8
2008e	73,483	2,439	720	0.09	-73.3%	25.8	0.0%	3.1%	0.8
2009e	60,355	1,951	510	0.07	-29.2%	36.4	0.0%	2.1%	0.8
2010e	64,162	5,029	2,954	0.38	479.1%	6.3	4.2%	10.8%	0.6

Notes: price at close of 31 March 2009. * = Based on HSBC EPS (fully diluted). Source: Company data, HSBC estimates

HSBC

Pacific Basin, 2343, OW(V)

- Profitable in 2009-10e even at low spot rates
- Benefits from handysize scrapping potential, offsetting oversupply
- We have an Overweight (V) rating and HKD5.4 target price

We forecast Pacific Basin will make profits in 2009-10, despite the industry's low spot rates. The group has covered 60% and 28% of its 2009 and 2010 handysize days, respectively, and more than 100% of its handymax days at rates that are significantly higher than y-t-d one-year average rates.

In the medium term, we believe Pacific Basin is defensive compared to most other dry bulk shipping companies because it mostly operates smaller handysize vessels. We argue that handysize rates are more defensive than larger vessels such as capsize because of the high scrapping potential of the ageing global handysize fleet. Handysize vessels also serve a niche market where they are not easily substituted with ability to operate at smaller and shallow ports.

Furthermore, Pacific Basin faces lower counter-party risk: chartering to well-capitalised producers and end-users of industrial cargoes and receiving 95% payment upfront on charter. It has a strong balance sheet with gross cash totalling USD1,019m and net cash of USD121m at end 2008.

Valuation. We reiterate our Overweight (V) rating with 58% potential return, including 5% dividend yield. Our HKD5.4 target price is based on replacement value per share. We value fleet at HKD4.3 (consisting of dry bulk fleet value of HKD2.4 based on sales and purchases since early 2009 and other fleet value of HKD1.9), net cash position of HKD0.8, and use FY09e EPS of HKD0.4.

Risks. Loss of key managers is a risk. Pacific Basin may be exposed to spot rates in 2011, but we expect scrapping to mitigate oversupply. Takeovers and asset acquisitions are potential catalysts.

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Key financials & valuation

Share price: (HKD) 3.53 — **Market cap:** (HKDm) 6,168

Year to	Net sales (USDm)	HSBC EBIT (USDm)	HSBC net profit (USDm)	HSBC EPS (USD)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
12/2008a	909	305	314	0.19	-32.5	2.4	22.2	30.1	0.7
12/2009e	485	111	78	0.05	-75.0	9.8	5.1	5.7	0.5
12/2010e	464	78	51	0.03	-35.4	15.1	3.3	3.0	0.4
12/2011e	433	70	45	0.03	-11.7	17.1	2.9	2.3	0.3

Notes: price at close of 31 Mar 2009. * = Based on HSBC EPS (fully diluted). Source: Company data, HSBC estimates

HSBC

Punjab National Bank,

PNB, OW(V)

- Likely better placed than peers on profitability and asset quality
- Superior funding mix, high provision cover set it above peers
- We have an Overweight (V) rating and INR485 target price

Punjab National Bank (PNB) is one of the stronger plays among the state-owned banks. NIM for the quarter ended December 2008 was 3.85%, next best to HDFC Bank and one of the highest among state- owned banks under our coverage. This has the benefit of a superior funding mix with the current and savings account (CASA) ratio at 39%. Net NPLs declined 58% y-o-y as of end 2008, pushing down net NPA (as a percentage of customer assets) to 0.39% versus 1.33% a year ago. PNB has kept these key strengths intact – near lowest NPLs and near highest margins. Given such challenging times, a superior funding mix and cleaner balance sheet are likely shields to profitability.

Valuation. We use a combination of economic profit model (EPM), PE, and PB. We assume a risk free rate of 9.5%, a beta of 1, and an equity risk premium of 6% which translates into a value of INR407 under the EPM method. On PE and PB we value the stock at INR586 and INR540 respectively. Our target price of INR485 is a weighted average in which EPM is assigned a weight of 50% and PE and PB 25% each.

Risks. Loan growth could be lower than our estimates, leading to lower-than-estimated NIM; provisions for loan losses could be higher than our estimates, leading to lower-than-estimated net profit; CASA deposit growth could be lower than estimated leading to a higher cost of funds; and macroeconomic risk could worsen.

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Key financials & valuation

Share price: (INR) 411 | **Market cap:** (INRm) 129,731

Year to	Net sales (INRm)	HSBC EBIT (INRm)	HSBC net profit (INRm)	HSBC EPS (INR)	HSBC BPS (INR)	PE* (x)	PB (x)	ROA (%)	ROE (%)
FY2008	55,342	40,062	20,488	65.0	342.0	6.3x	1.2x	1.13	19.6
FY2009e	68,917	45,390	22,830	72.4	399.8	5.7x	1.0x	1.05	19.5
FY2010e	78,085	51,129	26,626	84.4	467.8	4.9x	0.9x	1.07	19.5
FY2011e	86,679	57,139	29,436	93.4	544.8	4.4x	0.8x	1.08	18.4

Notes: price at close of 31 March 2008. * = Based on HSBC EPS (fully diluted). Source: Company data, HSBC estimates

HSBC

Reliance Industries, RELI, OW(V)

- Volume growth likely to offset margin decline over FY09-11e and result in 77% absolute growth in EPS estimates
- Existing RIL and new RPL refineries well positioned to outperform the Asian benchmark indicator margins
- We have an Overweight (V) rating and INR1,640 target price

Reliance Industries (RIL) is implementing two large-scale projects – 80MMcm/d natural gas production from KG-D6 by 2H FY09 and a 580Mbbl/d greenfield refinery at Jamnagar through Reliance Petroleum (RPL). RIL is also ramping up crude production from the MA-1 discovery field, (scheduled completion by FY10) to 40Mbbl/d. These developments translate into 77% growth in our EPS estimates for FY09-11e, even after factoring in mid-cycle refining and petrochemical margins. RIL's refining assets, which have the capability to produce high-quality fuels from cheaper crude sources, position the company well for competition in a weak environment.

Valuation. Our target price of INR1,640 is based on a sum-of-the-parts valuation of RIL's core business. Our valuation for the petrochemical and refining business is a combination of DCF-based valuation (50% weight; WACC of 11.7%) and relative valuation (50%) based on an FY11e EV/EBITDA multiple of 6.0x.

Risks. The risks to our rating include materially lower refining and petrochemical margins, lower long-term oil and gas realisations and a lower US dollar than used for our assumptions. Company-specific risks include recoverability of reserves, project ramp-up of the oil and gas and refinery production, and litigation over gas pricing (KGD6) in the Mumbai High Court.

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Key financials & valuation

Share price: (INR) 1524.75 | **Market cap:** (INRm)2,399,649

Year to	Net sales (INRm)	HSBC EBIT (INRm)	HSBC net profit (INRm)	HSBC EPS (INR)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
03/2008a	1,371,467	181,404	147,879	99.35	17.1	15.3	0.8	20.1	2.7
03/2009e	1,626,263	189,598	151,590	95.76	-3.6	15.9	0.7	16.6	2.6
03/2010e	1,874,575	247,874	202,556	123.28	28.7	12.4	0.8	19.3	2.2
03/2011e	2,582,126	335,490	278,812	169.70	37.6	9.0	1.0	22.4	1.8

Notes: price at close of 31 Mar 2009. * = Based on HSBC EPS (fully diluted). Source: Company data, HSBC estimates

HSBC

Shanghai Electric, 2727, OW(V)

- Large secure orderbook and lower material costs to put an end to downward earnings trend
- Net cash position and high interest cover provide a strong degree of comfort
- We have an Overweight (V) rating and HKD3.70 target price

We expect cyclical stocks like Shanghai Electric to lead in the recovery with a strong order book, increased government spending and lower material costs. The bottoming of the earnings decline, which we estimate in 2H09, should be a catalyst for the stock price.

We estimate 1H09 earnings to be lower (YoY) but margin should stabilise, setting a floor to the y-o-y earnings decline. Steel costs have fallen steeply since mid-2008 – benefits to Shanghai Electric should accrue with a 9-12 month lag. Locally produced and lower cost special steels substituting imported steel should also help.

With an order backlog of 4.3x 2008e revenue (as at 3Q08), net cash of RMB10.4bn (2008e) and interest cover of 86x (2008e), Shanghai Electric is well positioned to benefit from the current economic downturn.

Valuation. Our target price is based on a target MACC of 18% and ACROIC (adjusted cash flow return on invested capital) of 9%, which translates into 12x our 2009e EPS and 1.9x our 2009e book value per share. The shares currently trade at 7.5x forward PE and 1.1x forward PB. We rate the stock Overweight (V).

Risks. Key risks include a dramatic slowdown in the Chinese economy and higher capacity expansion by competitors than we expect.

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Key financials & valuation

Share price: (HKD) 2.23 | **Market cap:** (USDm) 6,207

Year to	Net sales (RMBm)	HSBC EBIT (RMBm)	HSBC net profit (RMBm)	HSBC EPS (RMB)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
12/2007a	56,437	3,338	1,629	0.14	9.3	14.6	2.2	9.2	1.3
12/2008e	61,549	3,823	2,438	0.21	49.6	9.7	2.8	12.3	1.1
12/2009e	74,089	4,680	3,320	0.27	29.5	7.5	3.1	14.9	1.1
12/2010e	77,191	5,462	3,915	0.31	17.9	6.4	4.0	15.6	0.9

Notes: price at close of 31 Mar 2009. * = Based on HSBC EPS (fully diluted). Source: HSBC estimates

Siliconware Precision,

2325, OW(V)

- High quality semiconductor name at relatively low valuation
- Near-term strength from top customer Nvidia and MediaTek to drive significant increase to consensus
- We have an Overweight (V) rating and TWD41 target price

From an overall technology perspective, we believe a rebound in fundamentals is under way. While this bounce may only be inventory stocking related, we expect a lot of positive news flow (preannouncements, monthly sales, results) to drive tech shares near term. We recently advised investors switch to Siliconware from TSMC (same exposure to high quality semi name, but at lower valuation). Specific to Siliconware, we focus on relative strength and valuation as we expect it to see the greatest increase to consensus estimates this results season. We estimate 2009 revenue will decline 18% y-o-y (23% above consensus). Near term, we believe a combination of strong wafer start activity at key customers such as Nvidia and Mediatek will drive 2Q09 revenue up 25-30% q-o-q. When combined with recent cost controls and better fixed cost absorption, we believe margins will expand more rapidly than expected, resulting in 2Q09 net income increasing nearly 4x q-o-q. Our 2009 EPS of TWD1.77 is more than double consensus. Our 2010 revenue forecast represents 20% y-o-y growth and is 18% ahead of consensus. Our 2010 EPS of TWD2.90 is 57% higher than consensus.

Valuation. We base our TWD41 target on 2.2x PB, at the lower end of the 1.5-3x range in recent years (Siliconware is a cheaper alternative to TSMC at 3x book). The shares are trading at 14x our 2010 EPS, with a 5% dividend yield this year and next. We also view the underperformance of Siliconware vs. ASE as unjustified. ASE shares are up 46% in the last 30 days compared to 31% for Siliconware (24% for TAIEX).

Risks. Limited visibility, higher raw material costs, FX rates, pricing pressure from large number of players, market share and end market shifts, a relatively new China expansion strategy.

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Key financials & valuation

Share price: (TWD)38.90 — **Market cap:** (TWDm) 122,636

Year to	Net sales (TWDm)	HSBC EBIT (TWDm)	HSBC net profit (TWDm)	HSBC EPS (TWD)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
12/2008a	60,474	8,873	6,314	2.01	-65.6	19.3	11.6	9.8	2.1
12/2009e	49,462	5,533	5,637	1.77	-11.8	21.9	4.7	9.7	2.2
12/2010e	59,296	9,657	9,306	2.90	63.2	13.4	4.2	15.9	2.1
12/2011e	62,124	10,565	10,115	3.11	7.3	12.5	6.9	17.1	2.2

Notes: price at close of 02 Apr 2009. * = Based on HSBC EPS (fully diluted). Source: Company data, HSBC estimates

HSBC

Sinopec, 386, OW(V)

- 2H08 net profit up 161% over 1H08 on improved refining margin
- We expect 2009 earnings to jump on higher refining margin due to fuel price reform
- We have an Overweight (V) rating and HKD6 target price

Sinopec reported stronger earnings growth in 2H08 than in 1H08 on improved refining margin (-USD0.5/bbl vs. -USD14.5/bbl). We expect the momentum to continue in 2009, with strong refining margin after the pricing reform and estimated EPS growth of 74% to RMB0.59 (HKD0.68) in 2009. We conservatively assume a China refining margin of USD6/bbl in 2009. For every extra dollar per barrel in refining margin, Sinopec's 2009e earnings improve by 12% over our base case (USD6/bbl).

In 2009, Sinopec plans to increase oil production by 1.4% to 42.4mt, gas production by 20% to 10bcm and crude processing by 9% to 184mt in 2009. It has also budgeted capex of RMB111.8bn for 2009, up 4% y-o-y, and plans to reduce operating cost by RMB2.8bn. The company announced that it will acquire from its parent the following assets: 1) eight oil product pipeline project divisions; 2) a 100% interest in Qingdao Petrochemical, a refinery; 3) a 41.99% interest in Shijiazhuang Chemical Fibres; and 4) certain assets in Shengli and Shijiazhuang. We believe these measures will further expand its scale and enhance cost competitiveness.

Valuation. Our price target of HKD6.0 is based on a PE multiple of 8.8x, which is derived by applying an 18% discount (ie average one-year PE differential between Sinopec and the MSCI China Index) to HSBC's 12-month forward target PE of 10.7x for MSCI China. We rate the stock Overweight (V).

Key risks. Lower-than-forecast oil and natural gas prices, declining production growth in mature oilfields, and lower than expected oil production and crude oil processed are key risks.

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Key financials & valuation

Share price: (HKD) 5.15 — **Market cap:** (HKDm) 446,518

Year to	Net sales (RMBm)	HSBC EBIT (RMBm)	HSBC net profit (RMBm)	HSBC EPS (RMB)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
12/2007a	1,209,706	85,864	58,743	0.65	5.5%	7.7	3.29%	18.4%	1.4
12/2008a	1,502,443	28,123	26,115	0.34	-47.7%	14.7	2.33%	6.9%	1.3
12/2009e	1,086,426	75,252	52,702	0.59	147.8%	7.6	3.29%	13.6%	1.0
12/2010e	1,480,110	106,091	74,561	0.84	42.4%	5.4	4.65%	16.5%	0.9

Notes: price at close of 31 Mar 2009. * = Based on HSBC EPS (fully diluted). Source: HSBC estimates

HSBC

Sinotrans, 598, OW(V)

- Demand for logistics services has dropped due to collapsed trade activity since 4Q08; momentum set to turn around in 3Q09
- However, entry barriers and net cash suggest compelling value
- We have an Overweight (V) rating and HKD1.8 target price

China's trade and port data in recent months has shown a rapid deterioration in freight transport. This has negatively impacted Sinotrans' freight forwarding, logistics and shipping-related businesses.

Earnings momentum remains negative. Earnings momentum has been negative since late 2007. After Sinotrans' results announcement in March, consensus earnings have been cut 40-50%, and are now -15% and +8% from our 2009 and 2010 EPS forecasts, respectively. We believe momentum will bottom this quarter and turn around in 3Q09.

Valuation. We believe valuation is inexpensive at a 45% discount to book. Sinotrans' net cash balance makes up 70% of its share price, and due to bureaucratic hurdles it would be virtually impossible to replicate its logistics network in the medium term. Excluding cash, we estimate Sinotrans trades at 2x FY09e PE. We have used a sum-of-the-parts valuation employing a discount to overseas-listed logistics peers. Our target price of HKD1.8, which suggests 53% potential total return, implies a PE of 13x and a PB of 0.8x in FY10. The stock has no directly comparable listed peer group in Asia, which complicates the valuation of the group.

Risks. Sinotrans operates in a fragmented and dynamic industry. Therefore, revenue growth, the level of margins and the value assigned to its various businesses are uncertain. There is little visibility on the direction of container freight rates, which has been an important earnings driver in the past.

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Key financials & valuation

Share price: (HKD) 1.20 — **Market cap:** (HKDm) 5,099

Year to	Net sales (HKDm)	HSBC EBIT (HKDm)	HSBC net profit (HKDm)	HSBC EPS (HKD)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
2007a	38,877	2,102	642	0.15	49.6	7.0	5.7	7.8	0.5
2008a	41,369	1,851	536	0.13	-16.6	8.3	4.7	6.4	0.6
2009e	37,486	1,525	462	0.11	-13.8	9.7	3.1	5.7	0.5
2010e	39,309	1,720	592	0.14	28.3	7.5	4.0	7.0	0.5

Notes: price at close of 31 March 2009. * = Based on HSBC EPS (fully diluted). Source: Company data, HSBC estimates

HSBC

State Bank of India, SBIN, OW(V)

- Credit costs declined in 3Q FY09 despite above-sector average loan growth, a key differentiator versus peers
- Revenue drivers remain diversified; perhaps somewhat less "market-related"
- We have an Overweight (V) rating and INR1,340 target price

State Bank of India (SBI) bucked the trend in 3Q FY09 and surprised positively on two key metrics. Provisions and contingencies declined by a sharp 75% y-o-y, despite SBI growing at a pace much higher than the sector average. Annualised credit costs declined to 45bp in 3Q FY09 versus 86bp in the preceding quarter. This was unlike most Indian banks under our coverage, which had reported an increase in credit costs following the overall business cycle downturn. Another distinguishing feature of SBI's performance was a c60% growth in fee and commission income. This is unlike its Indian peers, most of which had reported lopsided non-interest income, largely driven by treasury gains. Given the uncertain times, we believe this kind of revenue diversification is a key strength and a shield to SBI's profitability.

Valuation. We use a combination of economic profit model (EPM), PE, and PB to value SBI. We assume a risk-free rate of 9.5%, beta of 1, and an equity risk premium of 6%. The EPM method gives a value of INR866 which includes the value of its stake in associates and subsidiaries (INR348). On PE and PB, we value the stock at INR2,152 and INR1,470 respectively. Our target price of INR1,340 is a weighted average in which EPM is assigned a weight of 50% and PE and PB 25% each.

Risks. Loan growth could be lower than our estimates, leading to lower-than-estimated NIM; provision for loan loss could be higher than our estimates, leading to lower-than-estimated net profit; cost of funds could be higher than our estimates leading to lower profitability; and macroeconomic risk could worsen.

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Key financials & valuation

Share price: (INR) 1,067 — **Market cap:** (INRm) 677,480

Year to	Net sales (INRm)	HSBC EBIT (INRm)	HSBC net profit (INRm)	HSBC EPS (INR)	HSBC BPS (INR)	PE* (x)	PB (x)	ROA (%)	ROE (%)
03/2008a	170,212	131,076	67,291	106.6	776.5	10.0x	1.3x	1.04	16.8
03/2009e	204,942	166,305	73,456	116.3	869.4	9.2x	1.2x	0.97	14.1
03/2010e	236,585	178,109	80,447	127.4	969.9	8.4x	1.1x	0.96	13.9
03/2011e	250,852	177,440	87,420	138.4	1,081.4	7.7x	1.0x	0.93	13.5

Notes: price at close of 31 March 2009. * = Based on HSBC EPS (fully diluted). Source: Company data, HSBC estimates

HSBC

Swire Pacific 'A', 19, OW(V)

- Swire's businesses are well positioned to weather slowdown
- HK rental portfolio remains defensive, while Beverages and Cathay to benefit from lower commodity and fuel prices
- We have an Overweight (V) rating and HKD59 target price

As demand slows in 2009, we argue Swire's businesses are well positioned. We expect property rental income to be defensive due to limited supply in HK. We believe Beverages will start to benefit from lower commodity prices. Cathay will enjoy an estimated HKD23bn buffer due to the fall in fuel prices. Although the marine division faces lower charter revenues, it has 60% of the vessel days fixed for 2009 and this niche is far less cyclical than the wider shipping market.

Valuation. We argue Swire's share trading range during the Asian financial crisis will provide the best guide to 2009 performance. In 1998, Swire shares' sunk to a 47% discount to appraised valuation and then averaged a 17% discount in the year after the low. Our target of HKD59 is set at a 17% discount to our appraised valuation of HKD71/share. Including FY09e DPS, this implies 19% return. We have an Overweight (V) rating.

Risks. Our appraised valuation is primarily sensitive to changes in the capitalisation rates used for HK property. We believe these capitalisation rates tend to be driven by the perceptions of the long-term cost of capital in HK and the likely long-term rate of rental growth. Based on our research, we believe these drivers will remain negative in 2Q09. Our target price is also sensitive to changes to the discount to appraised valuation.

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Key financials & valuation

Share price: (HKD) 51.70 — **Market cap:** (HKDm) 78,090

Year to	Net sales (HKDm)	HSBC EBIT (HKDm)	HSBC net profit (HKDm)	HSBC EPS (HKD)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
2007	21,687	6,055	8,653	5.69	25.9	9.1	6.2	21.0	0.6
2008	24,670	7,255	3,572	2.36	-58.4	21.9	4.6	4.4	0.6
2009e	25,109	7,405	6,694	4.45	88.1	11.6	4.6	4.9	0.6
2010e	26,080	7,432	8,604	5.72	28.5	9.0	5.0	6.1	0.5

Notes: price at close of 31 March 2009. * = Based on HSBC EPS (fully diluted). Source: Company data, HSBC estimates

HSBC

ZTE, 0763 , OW(V)

- Attractive alternative stimulus play and the biggest listed beneficiary of USD100bn in Chinese telco capex in 2009-10
- ZTE is a fast-growing, listed telecom equipment vendor, making huge gains in both domestic and international markets
- We have an Overweight (V) rating and HKD36 target price

ZTE is a China-driven story in 2009: the Chinese government is pushing a huge wave of investment in 3G, accelerating the development of the domestic technology sector at the expense of operators. ZTE is holding c30% of total domestic 3G equipment market share and c50% of TD-SCDMA handset market share in 2008, the investment in 3G networks and handset subsidies has begun to help the company's growth.

A stable gross margin, improving operating margin and positive operating cash flow in 2008 relieved investors' concerns and reaffirmed the company's healthy growth. The Chinese government is actively supporting it via technology transfers, export financing support, and managed domestic market share. We forecast ZTE revenue to reach RMB63bn in 2009, up 43% and net income of RMB2.6bn in 2009, up 57.5%.

We expect the stock will continue to run through the 1Q09 results, partly due to the domestic operators' revenue recognition; China Mobile's third phase TD-SCDMA tender in May will also be a near-term catalyst.

Valuation. Our target price of HKD36 is based on a target PE multiple of 16x 2009e EPS of RMB1.95 and an HKD-RMB exchange rate of 0.8717. The target multiple of 16x is a 40% premium to the 12-month forward PE for MSCI China of 11.5x. Our 40% premium reflects a combination of much higher earnings growth (57% EPS growth for ZTE vs. 2% for MSCI China) and ZTE's historic PE premium to MSCI China.

Risks. Key downside risks are lower margins in the domestic market (competition from Huawei), deterioration in accounts receivable (bad debt), and further slowing of global capex.

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Key financials & valuation

Share price: (HKD) 31.55 **Market cap:** (HKDm) 51,928

Year to	Net sales (RMBm)	HSBC EBIT (RMBm)	HSBC net profit (RMBm)	HSBC EPS (RMB)	EPS growth (%)	PE* (x)	Dividend yield (%)	ROE (%)	PB (x)
12/2008a	44,293	2,953	1,660	1.24	32.6	22.2	086	12.6	2.59
12/2009e	63,365	4,447	2,614	1.95	57.5	14.1	1.1	17.1	2.25
12/2010e	69,137	4,893	2,882	2.15	10.3	12.8	1.8	16..4	1.97
12/2011e	79,494	5,564	3,292	2.45	14.2	11.2	2.0	16.3	1.71

Notes: price at close of 31 March 2009. * = Based on HSBC EPS (fully diluted). Source: HSBC estimates

Disclosure appendix

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The following analyst(s), who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Garry Evans

Important disclosures

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Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

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Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

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Neutral (Hold)	37%	(30% of these provided with Investment Banking Services)
Underweight (Sell)	24%	(28% of these provided with Investment Banking Services)

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HSBC & Analyst disclosures

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Company	Ticker	Recent price	Price Date	Disclosure
AU OPTRONICS	2409.TW	29.45	02-Apr-2009	5, 6, 7
BANK OF CHINA LTD	3988.HK	2.67	02-Apr-2009	2, 4, 5, 6, 7, 11
CANARA BANK	CNBK.BO	165.15	02-Apr-2009	2, 4, 5, 6, 7
CHINA AGRI-INDUSTRIES HOL	0606.HK	3.88	02-Apr-2009	4
CHINA BLUE CHEMICALS	3983.HK	4.29	02-Apr-2009	4
CHINA COMMUNICATIONS CONS	1800.HK	9.15	02-Apr-2009	4, 6, 7, 11
CHINATRUST FHC	2891.TW	13.90	02-Apr-2009	2, 5
CIIH	0966.HK	13.40	02-Apr-2009	2, 5, 11
FUBON FHC	2881.TW	22.55	02-Apr-2009	2, 5
INDUSTRIAL COM BANK OF CHINA	1398.HK	4.11	02-Apr-2009	4, 11
INFOSYS TECHNOLOGIES	INFY.NS	1419.40	02-Apr-2009	6
KINGBOARD CHEMICAL	0148.HK	19.00	02-Apr-2009	1, 4, 5, 6, 7
MAANSHAN IRON & STEEL	0323.HK	2.95	02-Apr-2009	4, 6, 7, 11
PACIFIC BASIN SHIPPING	2343.HK	4.00	02-Apr-2009	2, 5, 6, 7, 11
PUNJAB NATIONAL BANK	PNBK.BO	428.85	02-Apr-2009	2, 5, 6, 7
RELIANCE INDUSTRIES	RELI.BO	1661.35	02-Apr-2009	2, 5, 6, 9, 11
SINOPEC	0386.HK	5.47	02-Apr-2009	2, 4, 5, 6, 7
SINOTRANS	0598.HK	1.31	02-Apr-2009	6, 7, 11
STATE BANK OF INDIA	SBI.NS	1147.05	02-Apr-2009	2, 5, 6, 7
SUN HUNG KAI PROPERTIES	0016.HK	77.65	02-Apr-2009	2, 5, 6
SWIRE PACIFIC	0019.HK	55.70	02-Apr-2009	2, 4, 5, 6, 7, 11
ZTE CORPORATION	0763.HK	33.80	02-Apr-2009	4

Source: HSBC

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