



▶ HSBC Investments | February 2007

curious to know?



Richard C. Wong, MBA
Investment Director, Equities
Halbis Capital Management (UK) Limited

Correction in China Equity Markets

China markets fell significantly 31 January 2007. A-shares fell by over 5%, H-shares, red chips and the Hang Seng index fell by close to 2%.

China markets in general have performed strongly over the past year. A-shares were up over 125%, H-shares doubles and the Hang Seng Index rose by 36%. Fund inflows into the China equity market were especially strong at the tail end of 2006 and into 2007. In the last two months A-shares have risen by about 32.5%.

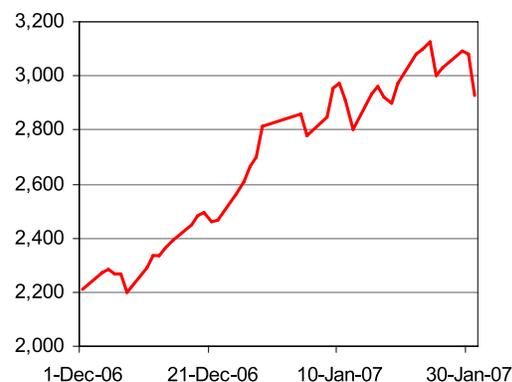
The fall was triggered by investor expectations that the Chinese authorities may implement measures to stem activity in the equity markets. This followed comments from an influential Chinese official, Cheng Siwei, Vice Chairman, China National People's Congress, who stated that there is a bubble in markets and that investors should be concerned about the risks.

Given the rapid rise in the A-share market, and the possibility of further policy measures, short term market consolidation is possible.

Though valuations have risen for China shares and A-shares in particular, they still remain reasonable, and should be supported by strong earnings growth in 2007.

Despite volatility in the short term, the growth story for China in 2007 is still strong. Positive momentum has been underpinned by strong economic growth (close to 10% annually in the last few years) and growing domestic consumption. While the government has instituted austerity measures in the past to cool the economy, it is still on track for strong growth of around 9%, in 2007.

Shanghai A-share Index



Source: Bloomberg

	2007 PBV (x)	2007 PE (x)	Mkt cap (US\$bn)	No. of listed companies
'H' Shares	3.1	15.1	432.1	141
Red chips	3.0	15.3	377.7	89
Shanghai A	3.9	18.8	911.2	832
Shenzhen A	3.7	17.2	217.8	566
Shanghai B	2.3	17.6	6.3	54
Shenzhen B	2.9	15.0	10.1	55

Sources: BNP Paribas



Corporate earnings for Chinese companies should also continue to remain strong with earnings growth of 30% in 2006 and 15% in 2007, driven by domestic consumption. The China market is trading at a forecast price-to-earnings ratio of 20.3 times in 2006, and 17.6 times in 2007.

There are also several short to medium term drivers for the market and they include:

- ◆ Potential Qualified Domestic Institutional Investor Scheme (QDII) approvals
- ◆ Corporate reform in the A-share market
- ◆ Potential revaluation of the Renminbi
- ◆ Lowering of profit tax for listed companies
- ◆ Positive investor sentiment in the run-up to the Olympics

In 2007, there may also be some volatility as a result of slowing global growth. In addition, China's ballooning trade surplus may lead to trade frictions with its major trading partners such as the US and Europe. Recent market strength may also lead to a surge in cash raising activities including IPOs and share placements and trigger some profit taking. This however, should not significantly affect the positive growth trend for the China equity market.

curious to know?

Despite volatility in the short term, the growth story for China continues to be strong. As the China market performance still lags behind other large emerging markets such as Brazil, Russia, India over the past three years, we believe China shares will have the potential to catch up due to strong economic growth (close to 10% annually in the last few years), growing domestic consumption and strong investments. While the government has instituted austerity measures in the past to cool the economy, it is still on track for growth of around 9% in 2007.

The material contained in this presentation has been prepared by HSBC Investments (Canada) Limited, and is based on sources believed to be reliable. However, we have not independently verified such information and make no guarantee, representation or warranty and accept no responsibility or liability as to its accuracy or completeness. Opinions expressed in the document are subject to change without notice and this information is not intended to provide professional advice and should not be relied upon in that regard. You are advised to obtain appropriate professional advice where necessary and should consult your investment representative before considering a specific transaction. This document is not an offer to sell or the solicitation of an offer to purchase or subscribe for any investment. We, our affiliates and our officers, directors and employees may hold a position in any securities mentioned in this document (or in any related investment) and may from time to time add to or sell any such securities or investment. As well, we and our affiliates may act as market maker or have assumed an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis and may also perform or seek to perform investment banking or underwriting services for or relating to those companies.