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Companies Featured

001450.KS, 035250.KS, 1382.HK, 2353.TW, 2603.TW, 2609.TW, 2615.TW, CSV.AX, INBK.BO, UNSP.BO

July 12, 2010

Asia/Pacific Morning Meeting Summary

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What's Changed

Stock Rating Changes - Downgrades

Ticker	Company	Stock Rating From	Stock Rating To	Price Target From	Price Target To	ModelWare Estimate From	ModelWare Estimate To (FY)	Consensus*
2603.TW	Evergreen Marine	O	E	NT$25.00	NT$25.50	NT$0.91 NT$1.82 NT$2.42	NT$1.37(12/'10) NT$1.92(12/'11) NT$2.51(12/'12)	NT$0.70 NT$1.52 NT$1.71
2609.TW	Yang Ming Marine	O	U	NT$15.50	NT$16.00	NT$0.14 NT$0.56 NT$0.94	NT$0.85(12/'10) NT$0.64(12/'11) NT$1.03(12/'12)	NT$0.44 NT$1.08 NT$0.65

Company Initiations

035720.KQ	Daum Communications	-- --	E --	-- --	W99,000 --	-- --	W5,700(12/'10) W6,197(12/'11)	-- --
035250.KS	Kangwon Land	--	O	--	W23,000	-- -- --	W2,243(12/'10) W2,349(12/'11) W2,540(12/'12)	W2,088 W2,203 W2,227
UNSP.BO	United Spirits Ltd	--	O	--	Rs1,486.00	-- -- --	Rs34.26(3/'10) Rs39.14(3/'11) Rs52.64(3/'12)	Rs32.66 Rs44.83 Rs57.84

Industry Initiation

Industry Name	Industry View From	Industry View To	Report Headline
S. Korea Gaming	--	A	Regional Competition Could Further Ease Regulations
S. Korea Internet Services	--	I	OW NHN: Dominance to rise; UW NCsoft: Mkt too upbeat

Estimates/Price Target Changes - Up

Ticker	Company	Stock Rating From	Stock Rating To	Price Target From	Price Target To	ModelWare Estimate From	ModelWare Estimate To (FY)	Consensus*
012330.KS	Hyundai Mobis	-- --	O --	W239,000 --	W254,000 --	W22,682(12/'10) W24,867(12/'11)	W24,101(12/'10) W26,029(12/'11)	-- --
005380.KS	Hyundai Motor Co.	-- --	O --	W180,000 --	W195,000 --	W20,018(12/'10) W20,634(12/'11)	W21,594(12/'10) W23.206(12/'11)	-- --
INBK.BO	IndusInd Bank	--	E	Rs185.00	Rs195.00	Rs10.3	Rs11.2(3/'11)	--
000270.KS	Kia Motors	-- --	O --	W32,5000 --	W39,500 --	W40,39(12/'10) W43,17(12/'11)	W4,528(12/'10) W4,829(12/'11)	-- --
3339.HK	Lonking Holdings Limited	--	O	HK$6.20	HK$6.80	--	--	--
036570.KS	NCsoft	-- --	U --	W110,000 --	W150,000 --	-- --	W10,012(12/'10) W10,084(12/'11)	-- --
035420.KS	NHN Corp	-- --	O --	W210,000 --	W250,000 --	-- --	W10,607(12/'10) W13,448(12/'11)	--
1382.HK	Pacific Textiles Holdings Limited	--	O	HK$5.63	HK$6.00	HK$0.49 HK$0.54	HK$0.58(3/'11) HK$0.64(3/'12)	-- --
2615.TW	Wan Hai Lines	--	E	NT$20.50	NT$21.50	NT$1.11 NT$1.36 NT$1.76	NT$1.51(12/'10) NT$1.61(12/'11) NT$1.93(12/'12)	NT$1.10 NT$1.57 NT$1.96

Estimates/Price Target Changes - Down

2353.TW	Acer Inc.	--	O	--	NT$106	NT$5.80 NT$7.28 NT$9.00	NT$5.75(12/'10) NT$7.19(12/'11) NT$8.96(12/'12)	NT$6.07 NT$7.72 NT$9.90
000157.SZ	Changsha Zoomlion	--	O	Rmb33	Rmb29	--	--	--
0390.HK	China Railway Group	--	O	HK$8.20	HK$7.20	--	--	--
000528.SZ	Guangxi Liugong Machinery Co., Ltd	--	O	Rmb27.70	Rmb24.50	--	--	--
1618.HK	Metallurgical Corporation of China	--	O	HK$5.90	HK$5.30	--	--	--

Estimates/Price Target Changes - Up/Down

001450.KS	Hyundai Marine & Fire	--	E	--	W25,100	W3,475 W3,652 W3,620	W3,344(3/'11) W3,582(3/'12) W3,715(3/'13)	W3,089 W3,557 W3,869

* First Call consensus estimate

The Morning Call

Macau Gaming & Property: Stock Selection Ahead of 2Q Earnings Release

Macau Gaming & Property: Attractive

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Overview. Sands China (1928.HK, HK$11.50, E) andWynn Macau (1128.HK, HK$12.90, O) should see teen percentage growth in EBITDA QoQ, while Galaxy (0027.HK, HK$4.30, O) could see flattish results and MPEL (MPEL.O, US$3.88, E) likely will see a sequential decline. Wynn Macau and Sands China should also see margin improvement due to increased non-junket VIP business.

Near-term call based on 2Q EBITDA: Sands China has underperformed its peers by 15% since April. We expect 14% QoQ EBITDA growth, and reported growth at that level could help the stock outperform. Galaxy has outperformed by 14% since April. Flattish EBITDA in 2Q, which we expect, could cap its performance.

Medium term outlook: We continue to favor SJM and Galaxy. We note that our estimates are significantly higher than consensus (21% and 17%, respectively for 2010 EBITDA). SJM Holdings (0880.HK, HK$6.45, O) is on our Asia Pacific Top Ideas list.

S. Korea Gaming: Regional Competition Could Further Ease Regulations

S. Korea Gaming: Attractive

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Initiate coverage of the Korean gaming with an Attractive view: Following steady double-digit sales growth during the global financial crisis, Korea’s casino industry looks set to grow 11.8% in 2010 and 10.7% in 2011, demand for upscale leisure activity remains strong. We believe the recovery in GDP and disposable income growth will benefit the local casino market, and rising tourist volume continues to drive up foreigner-only casino sales.

How competitive are Korean casinos versus regional peers? Korean casinos have a geographical advantage over regional peers, are more efficient on a per-table basis, operate at higher margins, and appear attractively valued, in our view. The industry operates at a 26%-plus EBIDA margin and trades at 6.3x EV/EBIDA and 8.7x P/E on 2011 consensus estimates.

Kangwon Land (035250.KS, W18,550): Initiate at Overweight: We believe the Street is under-estimating the growth potential in the medium term, especially following the planned 2012 casino expansion.

S. Korea Autos & Auto Parts: Strong Brand Image Improvement Should Help Overcome

S. Korea Autos & Auto Parts: Attractive

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Reiterate Attractive industry view; Estimates, price targets revised up. Our changes reflect strong YTD sales, plus new model impact through 2012. The recent risk associated with Hyundai-Kia Automotive Group's potential bid for Hyundai E&C may not be synergistic nor create huge value. However, we believe this remains a minor issue vis-à-vis the group's surging growth momentum.

Strong evidence of improved brand image: Our analysis suggests that Hyundai Motor's car prices are approaching those of Japanese peers, narrowing the historical range of 10-20% gaps. We believe this is a result of company's significant improvement in its brand image, which should provide a significantly growth momentum. Hyundai is scheduled to launch 5 all-new models each year for 2010-11e, which should provide extra growth momentum, based on such improved brand image.

Hyundai E&C bidding remains a short-term risk: We no53 that uncertainties regarding Hyundai Motor's potential interest in Hyundai E&C mqy not create huge shareholder value, as it would be only 4% EPS accretive. However, generating ~W5tn EBITDA with W6tn net cash, this deal would not be too big a concern for investors, as the company is nearing the final phase of its overseas expansion. Therefore, we would recommend investors build positions on dips.

S. Korea Internet Services: OW NHN: Dominance to rise; UW NCsoft: Mkt too upbeat

S. Korea Internet Services: In-Line

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Remain Overweight on NHN (035420.KS, W198,000). We expect NHN's EPS growth momentum to accelerate (30%+ YoY in 2H10e) as its gaming business reignites, and 27% growth in 2011e with a rise in revenue market share on the expected switch of its top-tier search ad agency from Overture to NBP.

NCsoft (036570.KS, W205,500); Price target up, but remain Underweight. We see downside to lofty market expectations. Mounting competitive pressure should lead to market share loss for existing NCsoft games, implying downside to consensus estimates of flattish quarterly OP in 2010. To justify the current stock price, NCsoft would need 10% revenue growth in the future – or a big hit launched every other year, with no cannibalization.

Daum (035720.KQ, W83,900); Initiate at Equal-weight. Despite an expected near-term rise in the stock price on a strong 2Q10, we rate Daum Equal-weight, as concerns over a price per click drop for its Overture online ad agency in the next year lead us to forecast flat OP for 2011..

UNSP.BO, United Spirits Ltd (Rs1,286.50) /Great domestic business, but overpaid for W&M

Rating: Overweight
India Consumer: Cautious
Target: Rs1,486.00
52-Week Range: Rs1,513.90-827.80
Mkt. Cap(mn): Rs150,771
ModelWare EPS: Rs34.26 (FY 3/'10),

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Rs39.14 (FY 3/'11)

Initiate Overweight; 16% upside to price target. We value USL on a sum-of-the-parts basis, with the domestic business contributing Rs1,436 per share (97% of price target), Whyte & Mackay Rs(18) due to the high acquisition price and related debt, and otherassets and smaller businesses such as IPL and wines at Rs68.

Key investment debates:(1) How sustainable is the industry's and USL's domestic sales growth? *We believe the spirits industry in India has the potential to grow at a 16% CAGR over the next five years*. (2) Can volatility in USL's domestic business margins be reduced? *Yes, we expect USL to demonstrate 430 bps EBITDA margins expansion over the next five years.* (3) Is Whyte & Mackay a good strategic fit? *W&M is value-dilutive, but a strategic fit, in our view*.

Key value drivers: Launch of premium products in India; W&M's successful foray into new geographies; and Improved financial health of the group.

035250.KS, Kangwon Land (W18,550) /Attractive Value with a Regulatory Tailwind – OW

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Rating: Overweight
S. Korea Gaming: Attractive
Target: W23,000
52-Week Range: W19,350-15,100
Mkt. Cap(bn): W3,802
ModelWare EPS: W2,243 (FY 12/'10), W2,349 (FY 12/'11)

Initiate at overweight. We think the Street is underestimating the company's growth prospects and the easier regulatory stance on the casino industry. Moreover, at 5.3x EV/EBIDA and 8.0x P/E on our 2011 estimates, the stock trades at a discount of about 40-50% to regional peers. A strong cash flow business model, combined with attractive valuations, makes Kangwon one of the cheapest gaming plays in the region, in our view.

Where we differ: We are more bullish than consensus because we think the regulatory risk is now to the upside after government tightening in the past 3-4 years. Our earnings estimates exceed the Street's by 10% in 2012 and 34% in 2013 as we assume approval is obtained for a 25% increase in table/machine games.

Risks: 1) The government may not approve additional table/machine games; 2) The casino revenue cap may be more strictly enforced; 3) There may be pressure to over-invest in community projects that may not contribute to future growth; and 4) Additional local casino openings could cannibalize the company's business.

Company/Industry Analysis

AUSTRALIA

CSV.AX, CSG Limited (A$1.90) /Who says nothing ever happens in Adelaide?

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Rating: Overweight
Australia Emerging Companies: In-Line
Target: A$3.35
52-Week Range: A$2.30-0.89
Mkt. Cap(mn): A$456
ModelWare EPS: A$0.16 (FY 6/'10), A$0.23 (FY 6/'11)

Reiterate CSV as our top pick in IT services. This follows A$12mn in contract wins across five new South Australian Government clients. These contract wins give us greater comfort on our essentially unchanged F2011 EPS forecast, which is above consensus.

What we like: Five new client wins in a new geography are evidence that CSV is delivering on its differentiated pipeline. NAB is providing A$25m to CSV in a syndicated facility with CBA, increasing headroom and perhaps prompting a repayment of the Canon vendor financing, something the company has discussed before.

What we don't like: Balance sheet complexity. We'd like to see the fund arrangements simplified, namely via the repayment of the vendor finance, and see this as a clear catalyst for the stock.

Key catalysts include: 1) repayment of vendor finance from Canon. This would remove suspicion around the interest rate differential. 2) The performance of KMBS at the result – important in its own right, it provides a read-through on execution with Canon. 3) Performance of Ultranet – can demonstrate execution in a new specialist capacity. 4) Further contract wins – a source of future earnings upgrades..

CHINA

1382.HK, Pacific Textiles Holdings Limited (HK$4.36) /Very Strong F10, Maintain OW

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Rating: Overweight
China Textiles, Apparel and Footwear: Attractive
Target: HK$6.00
52-Week Range: HK$5.90-2.10
Mkt. Cap(mn): HK$6,248
ModelWare EPS: HK$0.58 (FY 3/'11), HK$0.64 (FY 3/'12)

Price target up; Maintain Overweight. The company posted strong F2010 results and declared a dividend (final + special) of HK$0.39 (9%-plus dividend yield). For F2011, we project net profit growth to decelerate to 4% on the back of gross margin contraction given the spike of commodity prices. However, this could be conservative given the company's cost control measures and improved production efficiency. Medium term, we expect more normalized earnings growth of ~10% absent major fluctuation in commodity price and more stabilized global macro backdrop.

F2010 net profit surged 113% to HK$803mn. This was ahead of our forecasts and the Street estimate by 25% and 18%, respectively, and was driven mainly by stronger sales growth and better gross margin which expanded by 6.3% to 20.8%.

Earnings revision. We have raised our F2011–12 earnings forecasts by 17–18% each year to factor in higher sales and margins. For F2011, we conservatively project earnings to grow by 4% to HK$833mn on the back of 11% sales growth and gross margin contraction.

HONG KONG

Capital Goods: Growth to Slow; Stay with High-Quality Industry Leaders

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Capital Goods: In-Line

China capital goods: Fecord half year in 1H10 on strong downstream capex, government spending and abundant liquidity. We expect 2H construction machinery sales growth to slow sharply, but remainhealthy at 15% YoY. Real challenges lie in 2011, especially 1H, when infrastructure constructionis expected to slow to 11% and machinery sector to dip to just3% YoY. However, amid the downcycle in next 12 months, we still highlight good investment value in leading industry players that are consolidating, penetrating new product categories, and actively exploring overseas markets.

Construction: Stick with Railway plays. Railway infrastructure investment rose 17.5% YoYin the first 5 months, while new contracts were up a substantial 65% in 1H10e. We remain more bullish than the market on railwayinvestment. CRGL (0390.HK, HK$5.17, O) remains our top pick, given it has both the best new contracts growth in 1H10 and visibility, and it seems well on track to lift gross margin.

Machinery: Stay with industry leaders with broader product lines, market share gains. Machinery delivery reached record levels in 1H10e– up75% from a low base in 1H09 and up 44% from the pre-crisis peak in 1H08. While we expect growth to slow, we still forecasta 15%-plus YoY increase. Lonking (3339.HK, HK$5.17, O) and Haitian(1882.HK, HK$5.39, O) are our top pick.

INDIA

INBK.BO, IndusInd Bank (Rs215.20) /F1Q11: Good Numbers

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Rating: Equal-weight
India Financial Services: In-Line
Target: Rs195.00
52-Week Range: Rs220.45-75.70
Mkt. Cap(mn): US$1,894
ModelWare EPS: Rs11.2 (FY 3/'11), Rs13.2 (FY 3/'12)

F2011 ahead of expectations; Remain Equal-weight. Net profit at Rs1,186 mn compares with our estimate of Rs1,050 mn, and was ahead given stronger-than-expected revenue progression. This was partially offset by costs running ahead of expectations.

Reported margins expanded by 13 bps QoQ to 3.32%: Expansion during the quarter was driven by a combination of improving CASA (+70 bps QoQ), increase in asset yields and shift in loan mix towards higher-yielding consumer loans.

Price target up to Rs195 on the back of increased earnings estimates. We maintain our Equal-weight position. The stock trades at 2.6x F11e BV (after factoring in a US$250 mn issuance) and 19x earnings; the strong stock performance since the new management took charge in Dec-08 has meant that valuations have re-rated significantly. We are aware of the longer-term potential of IndusInd but would wait for valuations to be digested and the rising rates theme to play out before turning more bullish.

S. KOREA

001450.KS, Hyundai Marine & Fire (W25,100) /Quick Comment: Lowering ROEV Outlook

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Rating: Equal-weight
S. Korea Insurance: Attractive
52-Week Range: W26,050-15,400
Mkt. Cap(bn): W2,018
ModelWare EPS: 3,344W (FY 3/'11), 3,582W (FY 3/'12)

Remain Equal-weight given lower ROEV to 15.3% in F2011 for a lower VNB growth, RBC capital cost. Within the sector, we prefer SFM (000810.KS, W200,000, O) due to its better operating ROEV of 18.4% with improving VNB growth outlook and improving premium mix.

What's new: HMF announced F2010 EV of W2.6tn with 27.8% ROEV, as audited by Towers Watson. EV was in line with our estimates, but VNB was 18% lower due to higher loss ratio assumptions. HMF reflected 2.3ppt higher loss ratio with recent deteriorating risk loss ratio trend.

F2011 outlook: We expect ROEV to fall even lower to 15.3% in F2011 due to negative new premium growth outlook and deteriorating premium mix. HMF expects -3% new premiums growth in F2011 due to high base in F2010. We forecast NB margin will even lower to 6.0% due to increasing savings-type products portion, despite no more DAC amortization effect.

SINGAPORE

Steel: China June Trade Data – Slowing Consumption

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Slowing apparent consumption: China Customs released preliminary June trade data. Overall, we see softening imports for base metals & increasing exports for steel, suggesting slowing apparent consumption in line with the moderating June PMI. In addition, we expect China production data, due 15 July, should slow from rapid growth levels seen for the past 12 months, especially in steel and aluminum where pricing is below marginal cost.

Steel net exports rose to 4.15mn tons, up 569kt MoM or 16%. Rising steel net exports in June suggest slowing apparent consumption in China and probably some frontloading trade due to scrap of 9% export rebate starting on 15 July. Looking forward, due to upcoming cancelation of export rebate, we think steel exports may have peaked in June.

Implications: 1) Non-Chinese steel names such as POSCO (005490.KS, W405K, O) should benefit. Investors may worry over the surge steel exports, yet it should come down from June levels. 2) Jiangxi Copper (0358.HK, HK$15, O):SHFE copper price starts to trade at premium to LME again, and with the tight concentrate and scrap supply (indicated by the drop in spot TC/RC and increase in scarp copper imports), refined copper imports should pick up in 4Q.

TAIWAN

2353.TW, Acer Inc. (NT$81.00) /2Q Preview: Euro Impacted Sales but Good OPM Control

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Rating: Overweight
Target: NT$106
Taiwan Hardware Technology: Attractive
52-Week Range: NT$105.50-60.00
Mkt. Cap(mn): NT$218,246
ModelWare EPS: 5.75NT$ (FY 12/'10), 7.19NT$ (FY 12/'11)

2Q results expected despite € volatility; Remain Overweight. 2Q sales may be slightly below our estimate due to € depreciation and order selection to protect profits, but we believe 2Q OPM will beat our prior forecast and even rise marginally QoQ despite drastic € depreciation. We maintain our 3Q estimate and forecast 3Q sales will grow 10%-15% QoQ with rising OPM in GM recovery and scale benefits.

3Q outlook –sub-seasonal uptick with rising OPM. Visibility remains low for 3Q and the World Cup may inhibit demand in early 3Q in Europe. But, a positive sign is that the € appears to have stabilized recently and €/US$ has rebounded ~6% from the bottom on June 7. Margin expansion remains one of Acer’s priorities despite challenges from demand uncertainty.

2603.TW, Evergreen Marine (NT$22.90) /Taking a Breather; Well Positioned for Recovery but Stock Upside Limited

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Rating: Equal-weight
Taiwan Transportation: In-Line
Target: NT$25.50
52-Week Range: NT$24.35-15.85
Mkt. Cap(mn): NT$71,250
ModelWare EPS: NT$1.37 (FY 12/'10), NT$1.92 (FY 12/'11)

Downgrade to Equal-weight. After rallying 28% since January and outperforming the Taiwan Stock Exchange by 38%, we believe that valuations are fair. We continue to believe that containership supply growth of 9% in 2010E and 7% in 2011E will be balanced by demand growth, resulting in sustained freight rate strength over 2H10-2011, with earnings likely to be better than bearish expectations. We think that EGM is in a sweet spot to capitalize on the recovery as its chartered-in and new-build ships will be at a lower cost than its peers, reducing its cost base and improving its margins and returns to shareholders.

Recent stock price strength has priced in most near-term positivesfrom strong 2Q. Results were sharply above consensus, with successful implementation of peak season surcharges and rate hikes. We believe that regional container shipping stocks, OOIL (0316.HK, HK$59.50, O) and NOL (NEPS.SI, S$2.06, O), could see more near-term upside from strong 2Q results and sustained strength in volumes and freight rates.

Revisit at NT$20-21: At 1.2x 2010E P/BV, we see limited upside to EGM stock. We recommend investors take a breather near term and look to accumulate at NT$20-21.

2615.TW, Wan Hai Lines (NT$20.20) /Maintain EW: Intra-Asia Exposure Defensive but Stock Fairly Valued

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Rating: Equal-weight
Taiwan Transportation: In-Line
Target: NT$21.50
52-Week Range: NT$21.50-14.65
Mkt. Cap(mn): NT$43,941
ModelWare EPS: NT$1.51 (FY 12/'10), NT$1.61 (FY 12/'11)

Remain Equal-weight. Our revised price target of NT$21.50, together with a 4% dividend yield implies a total return of 10%..

Defensive intra-Asia exposure: WHL derives ~70% of its liner revenue for 2010-12e from the intra-Asia routes, and thus its earnings are more stable than those of most Asian container shipping peers. Intra-Asia freight rates are much less volatile than long-haul routes; strong demand supports capacity injections and hence even amid significant losses on the long-haul routes, the Intra-Asia routes remain at breakeven / marginal loss levels. With increasing concerns on the sustainability of Europe/US demand for 2011, we believe that WHL's higher intra-Asia exposure is defensive.

What could turn us more bullish: Stronger-than-expected intra-Asia volume and freight rate recovery, WHL successfully cancelling or renegotiating down the prices of its new-build ships on order.

2609.TW, Yang Ming Marine (NT$19.10) /Taking Profit: Sustained Earnings Recovery but Stock Rally Not Sustainable

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Rating: Underweight
Taiwan Transportation: In-Line
Target: NT$16.00
52-Week Range: NT$19.70-10.00
Mkt. Cap(mn): NT$48,943
ModelWare EPS: NT$0.85 (FY 12/'10), NT$0.64 (FY 12/'11)

Downgrade to Underweight. YMM stock has rallied 66% over the past two months, sharply outperforming regional container shipping peers and the Taiwan Stock Exchange. YMM trades at 1.4x 2010E P/BV, above its historical mean and at a slight premium to regional container shipping peer average of 1.3x 2010E P/BV.

Strong stock performance has priced-in near-term positives: 1) strong container shipping volumes, load factors resulting in successful implementation of peak season surcharges and general rate hikes over 2H10; and 2) strong 2010 quarterly earnings sharply higher than consensus expectations. We forecast 2Q10 profit of NT$1.2 bn and full year profit of NT$3.7 bn, sharply above consensus.

Switching our preference back toWHL: Reversing our earlier preference for YMM over WHL, we think that WHL is better valued at current levels. We expect the conclusion of the China-ASEAN free trade agreement and the Economic Cooperation Framework Agreement between China and Taiwan to boost trade flows within the Asia region, with WHL as the key beneficiary due to its higher market share on the Intra-Asia route. Our new order of preference amongst the Taiwan container shipping stocks we follow is EGM, WHL, and YMM.

Strategy/Economics Analysis

Australia Strategy/Underweight Small Caps, But Adding Select Names

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Underweight small caps in a large cap portfolio: For a large cap manager with an S&P/ASX 200 benchmark, we recommend keeping an underweight position in small caps. This is not to say that select small caps won't outperform the benchmark over the term, but as a broad allocation we believe that small cap underperformance may last another two or so quarters.

Three reasons for our small cap caution: 1) Small caps are far more influenced by lead indicators than the regular sectors; 2) The Small Ordinaries relative P/E is not cheap, sitting almost on par with the broader index compared to a long run average of a 5% discount; and 3) Small caps don't always outperform, and cycles last 18-24 months.

We look to add four key small caps to our model portfolio, based on recommendations from our small cap team led by Chris Nicol. Our four additions are MIN (MIN.AX, A$8.39, O), CPB (CPB.AX, A$30.16, O), AHE (AHE.AX, A$2.30, O), SMX (SMX.AX, A$6.08, O). These additions fit with our strategic thinking: strategically we like late cycle industrials with exposure to mining and infrastructure spend, as well as select retailing exposure.

China Strategy/Marketing Feedback and Debates in Focus: Bottoming or Breaking Down?

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High level of uncertainty, rather than negative conviction, is discounting China equities, we sense, after visiting our largest institutional clients in Europe and Asia. While many clients expressed a worry about a China hard landing, very few appeared to expect it, but they're staying away from perceived risky assets until things stabilize. 'Guilty until proven innocent' was a common sentiment preventing equities from outperforming, we think. In our experience, such sentiment often preludes a sharp bottoming-out of the stock market, unless fundamentals have broken down.

The few net buyers we saw are focusing on valuation and long-term growth prospects in China, and are prepared to ride out near-term market volatility. However, even these buyers have limited risk appetite. Most are overweighting consumers and other defensive sectors, but none of them is overweighting the deep cyclicals that we favor.

Most clients are looking for catalysts that could cause the market to bottom and we point out a few: 1) A CPI peak in 2H10 could signal an end to China's fiscal tightening. 2) The establishment of the Rmb's appreciation trend against the US dollar in 3Q or 4Q of 2010 could finally trigger liquidity inflow. 3) A recovery of property transaction volumes from current stressed levels. 4) Potential policy boosts that could offset an external slowdown in 2H10.

Stock markets are second derivatives of expectations in reality, as a commonly perceived fundamental rule. One should buy stocks when things can only get less worse than the market expects, which we believe is now.

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(as of June 30, 2010)

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Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
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Underweight/Sell	348	14%	94	11%	27%
Total	2,562		851		

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