

Blue Horseshoe

This is a sales note and not a research report

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Highlights

- ❖ *Weak US data causing significant gyration in equity markets. The Bull-Bear index last week approached the level that generates a Buy signal.*
- ❖ *Shanghai Composite index is consolidating below 2720 level. But market breadth is strong and improving which suggests that a breakout will happen soon.*
- ❖ *Golden Week theme plays should attract investors' attention next few weeks. Hengdeli & Trinity could benefit.*
- ❖ *Trade: Long China Lilang (1234 HK)...recommended on Sept 1*

Equity Market:

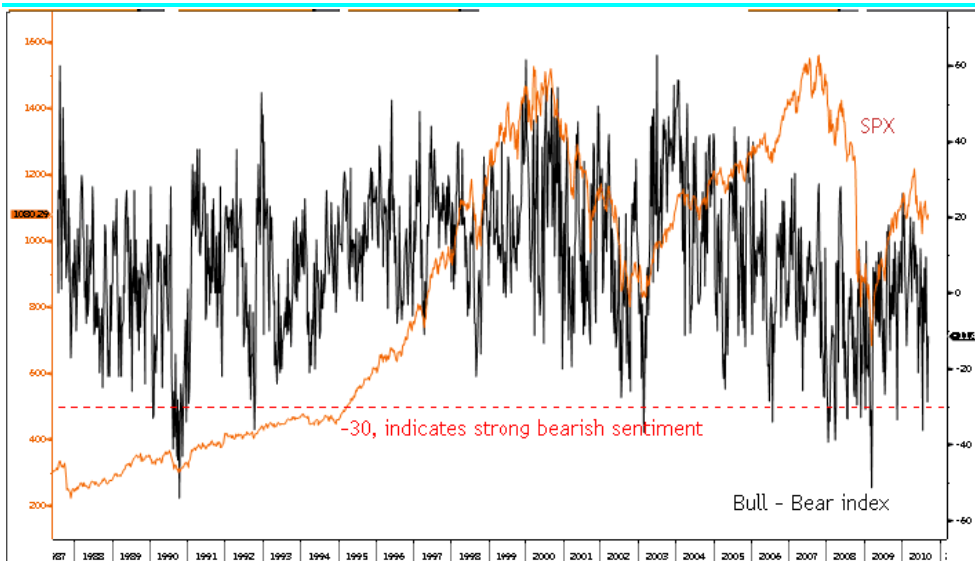
"When the market is doing something different from what it is supposed to do, it is doubly significant." – Justin Mamis

Investors' sentiment is fragile

Last week, the Bull-Bear index reached -28.7 indicating that market bounce was coming soon

Death Cross, the Hindenburg Omen, the Lusitania Omen, the Kindleberger Cycle, etc. In the past few months, the stock market was filled with warnings of impending doom. After reading an article on the Hindenburg Omen, a panicky friend called and asked whether she should sell her small stock holdings since the newspaper said the stock market was about to crash. Indeed, after two crashes in less than a decade, investors' psychology has been fragile. The Bull-Bear index shows that since peaking in the summer of 2003, the index has steadily trended lower. Even with last year's strong rebound in the market, the index barely reached above the +20 level which was considerably lower than July 03 period when the index was above +60. One important thing to note with regard to the Bull-Bear index. (Except in 2008, when there was a financial crisis and money condition was unusually tight, when the index reached -30 level or lower, it had almost always indicated a buying opportunity.) As recently as early July, the index hit -36 level and the S&P500 marked the bottom for the July period. As of last week, the index was at -28.7 indicating that pessimism in the market was strong. Right on cue, the US market had a follow-through day this wednesday after strong ISM mfg number.

Exhibit 1: S&P500 and (Bull – Bear) index, from 1987 to present



Source: Bloomberg, Daiwa Capital Markets Hong Kong Ltd.

-30 level generally indicates a buying opportunity

Chinese stock market had been supporting the global markets

If government's monetary tightening eases up, the Shanghai Comp index should break out above 2720

Despite the macro news with regard to the US economy, which had caused wild gyrations in the equity markets, we believe that investors should pay more attention to the Chinese economy (now the 2nd biggest in the world) and its stock market for clues to the end of the current bull market. Indeed, you can argue that since July the Chinese market had propped up the global equity markets. The market breadth, represented by % stocks above 50 and 200 MA, indicates that momentum is coming back to the market as expectations of soft landing begin to take hold with investors. Daiwa's economist Kevin Lai expects one more RRR hike and a 27 basis point hike in September. If that is the case, the Shanghai Composite index should break through the 2720 level which had capped the index the last 4 weeks.

Exhibit 2: Shanghai Comp with % of stocks above 50 and 200 days moving average



Source: Uputa, Daiwa Capital Markets Hong Kong Ltd.

The index is consolidating below the 2720 level for 4 weeks but market breadth continues to improve

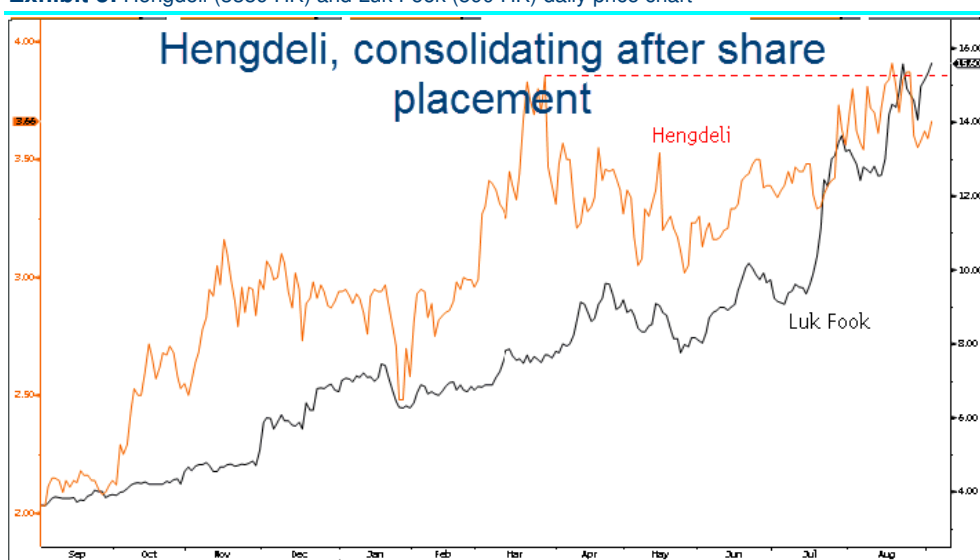
Jewelry and watches sales in HK and China continues to be strong

Hengdeli should benefit from the Golden Week theme

Parsing through this week's HK retail data, the data point that stood out was the "Jewelry, watches & clocks" segment which reported a 36% YoY growth. In HK, Luk Fook (590 HK) is up over 1000% in less than 2 years and continues to be on a strong uptrend on expectations of robust spending during the Golden week holiday in China. Even more amazing is King Fook (280 HK) which is up over 35% this week. Another stock that should also benefit is Hengdeli (3389 HK) which is consolidating after last week's share placement. Daiwa's Peter Chu reported that Hengdeli disclosed that its total sales in HK and China rose by 25-30% YoY for July. Also China's July retail sales data indicated that Jewelry sales increased 44.2% YoY. Below is Peter's O-PF report on Hengdeli.

https://lzone.jp.daiwacm.com/auth/user/OpenPDF?report_id=2010082600016&LANG=E

Exhibit 3: Hengdeli (3389 HK) and Luk Fook (590 HK) daily price chart



Source: Bloomberg, Daiwa Capital Markets Hong Kong Ltd.

Upcoming holidays in China a catalyst for sales

Strong execution with increasing ASP and margin expansion

Trinity, another interesting stock

Trade (Recommended on Sept 1):

Long China Lilang (1234 HK): We recommend going long Lilang. **Catalysts:** 1) The upcoming mid-Autumn festival in late September and the Golden Week (National Day) holidays in early October which should drive sales growth. The company announced that winter orders increased 33%. In general, ASP for 2H is approximately 40% higher than 1H. 2) Introduction of a new sub-brand, "L2", targeting consumers aged between 20 and 30 which should help extend the brand and increase sales. 100 "L2" stores are expected to be open by end 2010. **Background:** China Lilang sales grew by 31% in 1H10 with 14% volume growth and 15% increase in ASP. Operating profit increased by 47.8% with operating margin at 20.2%. The company has zero long term debt. **Stop loss:** HK\$9.4. Another stock that should benefit from the Golden Week holidays is Trinity (891 HK) which is rated a Buy by Daiwa analyst Peter Chu. Below is Daiwa's report on Trinity.

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Exhibit 4: China Lilang (1234 HK) daily chart with 20 and 50 MA



Source: Bloomberg, Daiwa Capital Markets Hong Kong Ltd.

Exhibit 5: Valuation table for other potential beneficiaries of Golden Week theme

	Bloomberg	Market cap	Share price	Target price			PER (x)			EBIT margin (%)			
Company name	code	(US\$bn)	(HK\$)	Rating	(HK\$)	+/- (%)	Year end	2009	2010E	2011E	2009	2010E	2011E
China Consumer Discretionary			1-Sep-10										
Apparel													
Ports Design	589 HK	1.4	19.44	1	24.80	27.6	Dec	20.4	16.7	13.8	34.0	38.0	41.0
Trinity	891 HK	1.2	6.13	1	7.38	20.4	Dec	41.2	29.6	21.2	15.7	20.2	23.2
Department stores													
Golden Eagle	3308 HK	5.3	20.45	1	20.85	2.0	Dec	130.8	37.3	29.1	52.5	49.6	48.6
Intime Dept Store	1833 HK	2.3	10.08	2	10.00	(0.8)	Dec	33.8	29.0	24.7	35.1	28.9	27.7
New World Dept Store	825 HK	1.5	6.75	3	6.70	(0.7)	Jun	20.7	18.9	18.0	35.8	36.9	33.9
Parkson	3368 HK	4.8	13.16	2	14.90	13.2	Dec	35.4	29.4	23.0	34.0	33.9	35.7
Footwear													
Belle	1880 HK	14.6	13.50	3	12.70	(5.9)	Dec	39.4	30.3	26.0	14.3	16.7	17.1
Sportswear													
ANTA Sports	2020 HK	5.0	15.48	2	16.85	8.9	Dec	27.0	22.3	18.4	23.8	24.2	24.6
China Dongxiang	3818 HK	3.0	4.13	2	5.93	43.6	Dec	14.0	12.2	9.5	42.7	41.1	43.3
Li Ning	2331 HK	3.3	24.15	2	28.00	15.9	Dec	23.3	20.0	16.5	16.0	15.1	15.1
Peak Sport	1968 HK	1.5	5.38	1	6.53	21.4	Dec	13.0	12.5	9.7	22.9	23.0	23.2
Watches													
Hengdeli	3389 HK	1.9	3.59	2	4.34	20.9	Dec	33.5	22.0	18.3	10.6	11.1	11.8

Source: Bloomberg, Daiwa Capital Markets Hong Kong Ltd.

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