Fourteen investment experts give their tips on where to put your money in the New Year, with the Hong Kong public's indomitable spirit and continued enthusiasm for new mainland company listings outweighing concerns that the Chinese economy may be overheating

China plays still flavour of the day

Trevor Cheung
Head of research
DBS Vickers

This year should be another good one for Hong Kong equities but the key indices are likely to consolidate at current levels in the first quarter, following the surge in the latter half of 2003. Acceleration in the global and regional economies would generally support an optimistic outlook for equities.

H-shares, red chips and China-related counters will remain the focus of the market. The oil majors and commodities plays are still well supported given our positive outlook on commodities prices, but are unlikely to repeat the spectacular performance seen last year.

The re-emergence of inflation on the mainland and rising household incomes will be a theme for 2004. Aviation, carmakers and select consumer plays stand to benefit. The financial and insurance counters, so far under-represented in the listed universe, will be the star performers.

The end of deflation and a rebound in confidence signal the beginning of a new consumption-inflation cycle in Hong Kong. Earnings should accelerate, with the traditional Hong Kong blue chips – properties and conglomerates – the likely winners. Hong Kong banks are expected to play a bigger role in the mainland's financial system, supporting further out-performance.

The small/mid cap industrials, darlings in 2002-03, could be further squeezed by higher raw material prices. Out stock picks are China Life Insurance, Wumart, Yue Yuen, Bank of East Asia and Sino Land.

As reluctant as I am to sit on the fence, I am prudent on stock picks and favour those companies with higher earnings visibility. China remains the investment focus and anticipation of higher tariffs and strong volume growth should help lift China Resources Power and Zhejiang Expressway. Beijing North Star should benefit from the booming automotive industry.

The IPO frenzy is likely to continue, especially for firms related to the mainland financial sector. This should have a positive effect on BOC Hong Kong Lastly, buy China Life on any market consolidation. Imagine what will happen if Warren Buffett, who also adores insurance firms, wants to repeat the sweet experience of PetroChina.

Linda Csellak
Investment director
Credit Agricole Asset Management

As I've learned to never doubt the Hong Kong economy's ability to respond to improving sentiment, I am optimistic.

The key drivers will be continued strong liquidity, declining unemployment, and improving consumer confidence, which should bode well for banks, properties and other domestically focused companies. China, both in terms of its own industrialisation process and its support for Hong Kong, will be key.

I like Esprit Holdings, both as a play on structural weakness in the US dollar and on fundamentals, with all of its geographical divisions performing well. As investors become aware of China Life Insurance's improving investment spreads, that stock should see a further re-rating.

Guangdong Kelon is undergoing a turnaround, and should benefit from increased demand for white goods from the rural Chinese

Hong Kong-based exporters. The US economic recovery is not very

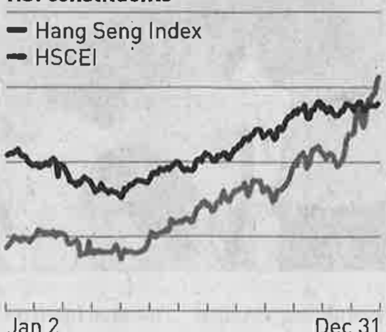
WALLED IN NO MORE

H shares, 2003 % change

Stock	% change
Chalco	▲ 441.3
Jiangxi Copper	▲ 354.8
Maanshan	▲ 344.0
Angang	▲ 275.0
China Shipping	▲ 254.9
Sinopec Zhenhai	▲ 250.5
Sinopec Beijing Yanhua	▲ 215.1
Sinopec Shanghai	▲ 192.4
PetroChina	▲ 185.3
Sinopec	▲ 163.3
Yanzhou Coal	▲ 153.2
Beijing Datang	▲ 124.2
China Telecom	▲ 123.8
Huaneng Power	▲ 113.5
Tsingtao Brewery	▲ 94.7
Sinopec Yizheng	▲ 94.1
Huadian Power	▲ 87.9
Zhejiang Copper	▲ 81.7
Jiangsu Expressway	▲ 79.4
Shenzhen Expressway	▲ 79.0
Qingling Motors	▲ 71.9
Anhui Conch	▲ 70.9
Guangshen Railway	▲ 67.9
Beijing North Star	▲ 62.5
China Southern	▲ 56.5
Travelsky	▲ 56.1
Beijing Capital Airport	▲ 51.4
China Oilfield	▲ 41.8
China Eastern	▲ 39.0
Sinotrans	▲ 29.6
BYP	▲ 29.4
Anhui Expressway	▲ 4.5

HSI constituent stocks, 2003 % change

Stock	% change
Espirit	▲ 95.1
BOCHK	▲ 84.8
Li & Fung	▲ 82.2
Bank of East Asia	▲ 82.1
Wheelock	▲ 76.4
Shanghai Industrial	▲ 62.8
Swire	▲ 61.6
TVB	▲ 59.4
CNOOC	▲ 49.0
Henderson Land	▲ 48.8
Wharf	▲ 48.8
HSBC	▲ 44.1
SHKP	▲ 40.3
Citic Pacific	▲ 39.4
Unicom	▲ 38.1
Cathay Pacific	▲ 37.9
Hang Lung Property	▲ 32.7
China Resources	▲ 31.8
Cheung Kong Infrastructure	▲ 30.8
China Mobile	▲ 28.9
Legend	▲ 27.9
MTRC	▲ 25.0
Henderson Investment	▲ 24.3
Cheung Kong	▲ 24.0
Hang Seng	▲ 23.3
Cosco Pacific	▲ 21.8
Johnson Electric	▲ 20.7
Hutchison Whampoa	▲ 18.5
Hong Kong & China Gas	▲ 17.9
CLP	▲ 17.5
Hong Kong Electric	▲ 4.6
Yue Yuen	▲ 4.4
PCCW	▼ 17.9



Un-priced event risks for 2004 (likelihood)

- Tung Chee-hwa removed from office, democratic elections ensue (<5%)
- Currency pegs are removed (<10%)
- Violent elections in India, reform slows (10%)
- China has a hard landing (15%)
- Trade Wars R Us (15%)
- Indonesia adopts more conservative policy agend after elections (15%)
- Yen overshoots, Japan's recovery curtailed (10-20%)
- Equity issuance explosion (20%)
- Marked downturn in Australia's housing sector and economy (30-40%)

PESSIMISM OVERDONE – WITH HINDSIGHT

market, should be key areas of investment focus.

(which is highly dependant on the commercial success of its 3G networks worldwide) and major property stocks. The key risk to our view is slowing growth in China and the US, which could derail the budding cyclical recovery.

Larry Jiang
Head of research
Guotai Junan Securities (HK)

What has driven the world markets higher in the past few months, should continue. The most important factors are the ongoing upgrade of corporate earnings, the end of bond bull markets and excessive liquidity.

For Hong Kong, we have additional benefits of re-ratings of stocks in general and Chinese shares in particular, a possibility of currency appreciation and inflation expectations.

However, facing multiple geopolitical risks, US rate increase prospects and a possible overheating of the Chinese economy, a key point to making money in 2004 is to know when to take the money off the table.

If the H-share and HSI indexes do reach our targets (5,500 and 15,000 respectively), unless new substantial positive factors emerge, the market might correct. We continue to like energy, financials, resources and selected consumer stocks, plus those with merger and acquisition potential; but be careful with textile, steel, carmaking and some manufacturing stocks.

We recommend China Merchant Holdings, PetroChina, Chalco, Chaoda Modern Agriculture and Sun East Tech.

Huimin Wu
Senior portfolio manager
State Street Global Advisors

John Koh

Fund manager
Daiwa Asset Management

For the past five years, I have advised my mother to include some growth stocks in her stock portfolio, including Hong Kong industrials and China plays, but she has outperformed me by keeping just one blue chip, HSBC. In 2003, at last, my portfolio recovered some lost pride for me.

I remain bullish that both the Hong Kong and Chinese economies will continue to boom in 2004, but less so than in 2003. Fortunately for us, the Chinese government will not tighten significantly and cause a hard landing. With a US presidential election on the way, we also don't see any drastic actions from the US Federal Reserve that will impact on the rebounding US economy. The only potential downside is a souring of Sino-Taiwan relations, but we expect the Chinese government to put pressure on Taiwan in the global arena, making military action unlikely.

Our target for the Hang Seng Index is another 15 per cent upside in 2004, with banks and property stocks likely to outperform given the economic recovery. For H shares, huge liquidity, strong corporate earnings and a robust economy will feed share prices. We expect a 40 per cent rise in the H-share index. As profit margins may be squeezed due to excess capacity and rising material costs, we should not be overly greedy and should take profits when possible.

Our top five picks for a HK/China portfolio are HSBC, Sino Land, China Merchants, Playmates and Skyworth Digital. Of course, we will also be trying our luck with those juicy IPOs.

Herbert Lau
Head of research
Celestial Asia Securities Holdings

Extreme market volatility is likely to continue this year given that most stocks ended at two-year highs, making the market more prone to heavy profit-taking when hot money or upbeat sentiment cools off.

Moreover, market valuations look quite rich on an historic basis. Certain cyclical stocks, in particular Chinese commodity-related plays, are seemingly running ahead of fundamentals, while most blue-chips should have largely factored in a lot of the recovery story. I believe a steep but healthy correction is overdue, which may take place sometime during the first quarter. Even so, the China story remains intact, which should prevent a crash similar to 1998.

population. As copper has lagged other metals until recently, I also like Jiangxi Copper as a pure commodity play. I would primarily avoid utilities and Chinese telecom companies, where competitive pressures and future 3G concerns may cap the upside.

I would also be cautious on export companies that are overly dependent on the US, since trade friction will be likely to increase as the US election draws closer. I still have concerns about how late into 2004 fiscal and monetary policy can keep US consumption at the current pace and I am therefore more cautious about the latter part of the year.

Adrian Mowat
Regional equity strategist
JP Morgan

A tale of two markets, three if one includes HSBC! Traditional Hong Kong companies have low growth prospects and are expensive while H shares promise high growth and lower valuations. China remains the hot story as demonstrated by over-subscriptions to IPOs and large inflows in China funds.

There are some symptoms of an investment bubble, but with the MSCI China trading 14 times next year versus MSCI Hong Kong's 18 times, expect Hong Kong investors to continue to have China fever. This may prove lucrative in the near term but remember that over-investment leads to lower returns in the long term. Be selective.

We have modest expectations for the Hang Seng index and MSCI Hong Kong. Low interest rates and substantial savings in low-return assets may result in higher returns. The H-share index we see generating high-single-digit returns over 2004.

But early in the year expect H shares to overshoot this target as enthusiasm for China and strong profits and economic data keep the market powering ahead.

Our top large-cap picks are China Unicom, Jardine Matheson, Yue Yuen, PetroChina, Hang Lung Group and Hong Kong and China Gas. Smaller names we like include Xinao Gas and Denway Motors.

Norman Ho
Fund manager
Value Partners

We are getting more cautious on China-related shares as their valuations look pricey after a strong run last year. Market expectations of economic growth in China are also too high. The Chinese economy may slow if the central government opts for policies to allow a "soft landing" on concerns of over-investment.

We are also cautious on some

solid, and the huge deficit is a key worry.

Most recently sought-after stocks, for example some H shares and the recent IPOs, do not offer good value.

But there are exceptions and some undiscovered stocks with single-digit price to earnings ratios look very attractive.

In particular we like the commodity sector, especially gold and oil, in light of the uptrend in the global commodity cycle.

Nilesh Jasani
Asian equity strategist
HSBC Securities

Amongst all the brouhaha over Beijing's supportive policy for Hong Kong, investors have underestimated three factors that will make the SAR one of the most stable and independent growth stories of 2004.

1) In Hong Kong's non-agrarian, non-manufacturing economy, markets have an impact on fundamentals. Equity markets rise and shopping malls become busier. People become more interested in buying property, consequently, banks' credit quality improves and jobs are created. All of this creates more positive news for equities. Around the middle of last year, the vicious cycle turned virtuous.

2) The evils of deflation, budget deficit, currency stability etcetera that appeared relentlessly depressing early last year will begin to disappear when growth returns. The Year of the Monkey should mark the return of pricing power and better fiscal balances, and hence, a further reduction in the risk premium.

3) Under a currency-board system, inflows cannot be easily sterilised. As a result, money growth skyrockets when foreign sentiment turns positive or when there is high growth in tourist spending. This factor alone more than takes care of any adverse liquidity impact from the rising primary market activities.

For the first few months, we expect the H-share index to retain its upward trajectory. Our analysts prefer banks, retailers and select conglomerates.

Yang Liu
Managing director
Atlantis Investment Management

If anyone gave you a year-end target for H shares above the 4,500 level at the start of last year, you would have thought they were crazy. I cannot predict where H shares will be at the end of 2004, but

Projections in 2002 for the performance of the Hang Seng Index in 2003 all undershot the actual outcome, and this was even before Sars set its gloomy mark on events.

The average forecast by the 10 analysts and fund managers polled by the *South China Morning Post* in 2002 was for the Hang Seng Index to finish 2003 at 11,380, roughly 1,195 points or 9.5 per cent below the actual close yesterday.

The worst forecaster was Merrill Lynch's Henry Ho, who set a year-end target of only 9,800, while Celestial Asia Securities' Herbert Lau was the most bullish, and thus also closest to the actual outcome, with a year-end forecast of 12,200.

Merrill Lynch declined to make a forecast for this year, while Mr Lau is looking for an 11 per cent gain, a projection largely in line with the poll average.

Last year's pollsters can be forgiven for missing one of the key stories of the year – Sars – which did not emerge until half-way through the first quarter, but they also underestimated the full impact of the United States recovery on the local economy. Anette Jönsson

I can tell you that they will challenge the August 1997 high of 7,499.28, and maybe in the next two years.

Commodity, resources, materials and in particular oil stocks will outperform, primarily driven by the sustainable demand-led growth in China.

I am also upbeat on the financially-related sectors, including banks and insurance companies with strong connections to or a presence in China which will create a lot of momentum and excitement in the coming years. Most of these stocks enjoyed a strong run in 2003 but I think their best is yet to come. I expect the companies to deliver strong earnings growth in 2004, and on the valuation front they are not pricey. When using price to earnings (P/E) as a gauge to value stocks, investors tend to focus a great deal on the "P" element. I would rather suggest they look for the "E" first.

In terms of overheating, I agree some segments such as high-end residential property and mobile phones are showing some symptoms, but I think these are not yet widespread across the economy.

Norman Villamin
Asia-Pacific strategist
Morgan Stanley

Though many have begun speculating that the end of Hong Kong's economic restructuring is near, its economic realignment will be complete only when jobs are being generated on a sustainable basis in key sectors, in particular those related to tourism and business services.

Despite a surge in tourist arrivals and improving profits in business services, job creation remains muted in both segments, leaving us cautious on the prospects for upside surprises on the economic growth front. This lends credence to our growing belief that recent efforts to speed the integration of the mainland and Hong Kong economies, while constructive, have long-term rather than the near-term benefits for the key jobs dynamic.

Indeed, the key question facing investors in Hong Kong is not whether recovery is emerging (it is), but whether equities are correctly anticipating the magnitude and duration of that recovery.

Given current earnings expectations and interest rates, Hong Kong equities are beginning to overprice the prospects for recovery. In fact, our MSCI Hong Kong fair-value models suggest that absolute return prospects are limited this year.

We estimate Hong Kong property stocks are as overvalued as at any time in the past 10 years, presenting the biggest risk to Hong Kong investors looking into the New Year. In contrast, the underperformance of the industrials in Hong Kong looks set to end, presenting the best relative performance opportunity for the coming year.

Stewart Paterson
Chief Asian strategist
Credit Suisse First Boston

We see two sets of conflicting forces affecting prices for Hong Kong-listed shares in 2004.

Global influences, which have been so supportive in the past six months, will likely turn negative in the second half – a factor that equities should discount in the first half. However, we expect a continued recovery in the domestic Hong Kong economy.

The local economy, after many years of deflation, has turned the corner. Growth in tourism from across the border, coupled with a very affordable and supply-constrained mass residential property

Continued low US interest rates, hence falling real rates in Hong Kong as deflation eases, will be supportive of domestic asset prices, including stocks.

Many H shares, however, are far more sensitive to the global growth outlook. A slowdown from breakneck speed growth in China, coupled with a significant rollover in growth momentum in the US in the second half is likely to leave many vulnerable.

Valuations among the more economically-sensitive stocks look stretched, as investor expectations are high. Overall, CSFB expects positive returns from domestic Hong Kong stocks, and negative returns from global cyclical stocks.

Timothy H. Moe
Chief Asia-Pacific strategist and
Kenneth Kok
Asia-Pacific strategist
Goldman Sachs

Following a strong equity market rebound of around 50 per cent from lows in late April, we expect moderate upside in 2004.

Within our regional market weight allocation, we are most overweight the banking sector, because it offers exposure to attractive investment themes at reasonable valuations. We also emphasise conglomerates, transportation and consumers, and note the value opportunities in the mid-cap segment. To fund these purchases we are selling telecoms, utilities and properties, the latter because we believe share prices have outstripped fundamentals.

We identify six key themes to watch in 2004: 1) Cyclical recovery – domestic demand rebound, asset price stabilisation; 2) Growth opportunities – Cepa, yuan deposit-taking; 3) China influence – tourism and liquidity; 4) People power – consumption, politics; 5) Stock-picking – small-mid-cap appeal; and 6) Structural challenge – defining Hong Kong's role with China.

Hong Kong's earnings growth and valuations are, in our view, not particularly compelling on an aggregated level and we see more growth opportunities and lower valuations in other Asia-Pacific markets.

We would be more positive on the Hong Kong market should we turn more positive on large caps such as Hutchison Whampoa

Our baseline assumes that all the positive factors will stay in full force – economic and asset price recovery will be the main stories in town. Economic growth will be led by both trade and consumption; the tourism industry will continue to benefit from increasing numbers of mainland visitors; consumption confidence is rising while the unemployment rate falls; property prices are likely to pick up gradually due to improved sentiment and better supply and demand conditions.

China's economic engine is still at full steam despite premature overheating concerns and likely modest monetary and industrial policy adjustments. The end of deflation will be good for asset prices and corporate profits and liquidity will continue to favour equities over bonds while the market gets more convinced of the sustainability of growth.

For the coming year, we continue to favour consumption plays, asset-price plays and selected China plays over utilities and telecom stocks. While we are more confident about the upside of Hong Kong's economy than the equity market since large-cap valuations have partly discounted the recovery scenario, liquidity will remain a wildcard for the upside of asset prices and equity market valuations in 2004.

Eugene Law
China analyst
Shenyin Wanguo

All in all, 2003 was a banner year for the China-concept stock. From a fundamental standpoint, we think the current market strength will continue in the first half of 2004, given strong local GDP growth and corporate earnings. The recent IPO frenzy also indicated that market demand for well-valued China stocks is huge and this abundant liquidity can be a powerful driver of performance for China stocks.

We are more cautious on the second half of the year. The key issue to watch is that the Chinese government may adopt further austerity measures such as credit tightening and a reduction in fixed-asset investment to cool down the overheating economy. We believe the Chinese economy is likely to slow in the second quarter. The possibilities of a US rate rise and a yuan revaluation may accelerate the slowdown and eventually hurt companies' bottom-lines.

We recommend the automobile, aviation and toll-road sectors for their structural growth and defensive nature. In addition, larger-cap stocks remain in favour due to their increased weightings in institutional investor portfolios and their reasonable valuations.