Sunday Morning Post

Your Money

Traders cautious on 'hot' markets

Reuters in Singapore

The next hot thing in commodities has been all the rage for the past two years. But some are worried the markets are getting ahead of themselves and need to take a breather.

From indium to uranium and from soy to coffee, commodities have been hitting multi-year highs, with China and the hedge funds variously blamed and cheered for roiling world markets.

One harried cocoa trader in Chicago said this week: "The funds are relentless. They are looking at the CRB and they are just buying everything …They are really ruining this market."

The Reuters CRB Index, which tracks 17 commodity futures, hit a 24-year peak last Wednesday as copper hit a new high at US$3,307 a tonne.

Investment houses, such as Goldman Sachs, are updating their forecasts with much higher prices on a range of tradeable goods.

"Better than expected economic activity leads us to push our near-term price forecasts, but we still expect metals to be broadly down by year-end," Goldman Sachs said in a base metals update this week.

The question is when will prices come down to earth and whether more corrections are in the offing in the near term, such as Thursday's 5 per cent fall in zinc prices on the London Metals Exchange.

"I think they have gone too far and people are lightening up a bit and taking some money off the table," said David Thurtell, commodity strategist for the Commonwealth Bank of Australia.

Most analysts see LME's marquee contract, copper, falling by year end but few want to be precise on the timing.

Goldman Sachs, for instance, now sees the three-month price on copper averaging $2,925 a tonne in the second quarter before falling to $2,500 by the end of the year.

Mr Thurtell agrees, to a point. "It's a brave person who says there is going to be a sharp fall," he said.

Metals prices could rise this week if the US dollar weakens after Tuesday's Federal Reserve policy meeting.

Last month commodity and energy funds ranked as the top-performing group among Hong Kong-registered funds, gaining 11.83 per cent, according to Lipper. Year to date the energy and natural-resources sector has gained 14 per cent, and 74 per cent over the past three years.

Companies on Nasdaq priced out of proportion relative to earnings potential

Valuations of Chinese stocks a tricky game for investors

Andy Mantel

Watching the bone-crunching tackles on the Sevens pitch this weekend reminds me a lot of the art of Chinese stock picking. The trick is to stay healthy and avoid getting stretchered off.

By the end of last year it was clear that the valuations of numerous Nasdaq-listed Chinese companies were priced out of proportion relative to expected future earnings potential.

On January 1 we recommended short-selling human-resource service provider 51job and online travel service provider eLong.

51job's market capitalisation was about US$1.5 billion at the start of this year. Since then the company's value has shrunk by about 70 per cent owing to a number of problems. Topping the list was the revenue and profit warning issued by company management in mid-January.

This has resulted in numerous class-action lawsuits by US investors regarding a number of issues including the allegation the company disseminated inaccurate operating information.

It will not be surprising to see insiders unload their positions when the firm's share lock-up period expires on March 28.

Shares in eLong have dropped about 60 per cent year to date. Management recently indicated the company would continue to lose money at least until the end of the first half. Online travel market leader Ctrip is successfully consolidating its No 1 position while other start-ups garner market share.

Another cause of concern is eLong's Form 6-K issued earlier this month reviewing its business operations for the year ahead. The first 20 pages of the 30-page document were devoted to risks related to its business. On this fact alone, we will not be surprised if forward revenue and net income numbers disappoint.

Another accident waiting to happen involves Shanghai-based online game operator and developer The9Limited. We like the business and management team, but the company faces unrealistic expectations after a December Nasdaq listing at a high valuation.

In what has become a common event, large US investment banks have successfully nurtured early-stage Chinese "technology" companies and listed them on Nasdaq at valuations two to three times what the company could have achieved in Hong Kong, if they could have listed at all.

Overall we are positive on the online game sector. Companies such as Shanda and Netease have credible business platforms.

The9Limited's initial online game "MU" has also been well received. Revenues have primarily come from this one source via its 51 per cent owned 9Webzen, a joint venture with Korea-based and Nasdaq-listed Webzen. MU is a 3-dimensional fantasy game played online with one or several players.

This year will be a critical year for The9Limited. Revenues from the MU are slowing just as the company plans to roll out a variety of self-developed and licensed games this year. Among them: World of Warcraft, a 3D online multi-player format developed by Blizzard Entertainment, the game development studio of Vivendi Universal.

In China online games must first obtain government approvals and then complete lengthy product trials. The good news is that The9Limited has a head start in some of these trial procedures.

However, we are not optimistic that the game maker will be able to match growth expectations. Last year the company had revenue of US$4.2 million and a market cap of US$400 million. Net income was US$3 million but the company enjoyed an exceptional gain.

We expect the share will struggle to rise much above US$17, the level where corporate insiders can excise options. When the six-month lock-up period ends in mid-May, we expect increased share-price volatility and most likely a decline.

The analyst for the investment bank that did the deal forecast early last month that The9Limited will earn 79 cents and US$2.05 a share, respectively. Our analysis indicates that the actual numbers should be considerably less. Last year the company earned 14 cents a share, a price/earnings of 121.5 times.

Andy Mantel is managing director of Pacific Sun Investment Management and manager of The China Mantou Fund. The fund is available to accredited professional investors only. info@pacificsun.com.hk

WHAT THE BROKER SAYS

Smith Barney has a "sell" recommendation on HSBC saying the bank is not making its rating and has failed to deliver superior operating profit growth compared to other European banks.

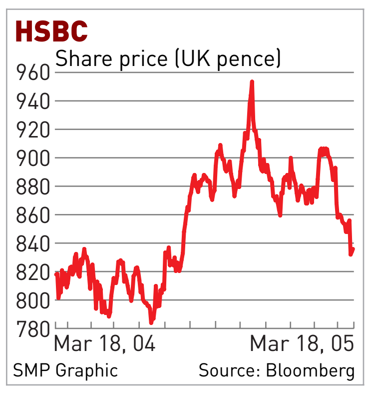
With costs building and margin pressures evident in key areas the broker sees little change soon. The continued negative investment case is driven by three factors.

Firstly, the operational performance of the group remains lacklustre, with an apparent inability to generate revenue growth in excess of cost growth. This is in part a function of the group's geographic footprint, with a dominant proportion of its earnings derived from the mature markets of Britain, Hong Kong and New York.

Secondly, the broker is unconvinced of the group's merger and acquisition record, saying the addition of US consumer finance group Household International in 2003 has disappointed.

Finally, it is believed the substantial valuation premium the group enjoys over its peer group is unjustified.

After HSBC underperformed the British equity market 8 per cent last year, the broker retains a 3M (sell/medium risk) recommendation and lowers its target from 775p to 750p. The counter closed at 836p on Friday.



SMP Graphic Source: Bloomberg

WHAT THE BROKER SAID

About a year ago Tai Fook Research placed a "buy" recommendation on Kingdee International Software Group and set a price target of $4.60. It expected the company's net profit to increase by 31 per cent to 77 million yuan last year.

Based in Shenzhen, the company employs more than 2,000 staff in 46 places and has three research and development centres in China. It was the first mainland software firm to list on the Growth Enterprise Market in 2001.

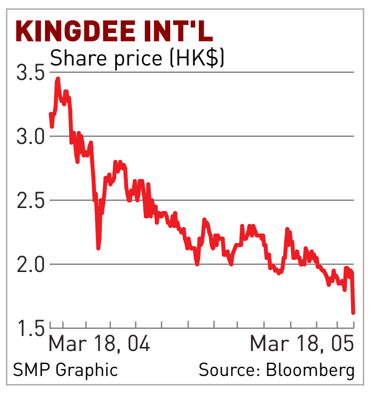
Kingdee reported a 45 per cent increase in net profit to 59 million yuan for 2003 while turnover rose 24 per cent to 366 million yuan.

Gross margin was maintained at 84 per cent and net margin improved to 16.2 per cent from 13.8 per cent the year before. Software sales accounted for 81 per cent of turnover while the rest was contributed by its servicing business.

The company was expected to expand in software outsourcing. In addition, its EAS software was expected to underpin an estimated 26 per cent sales growth to 460 million yuan.

Tai Fook said research and development expenditure would peak in 2004. Kingdee held cash of 144 million yuan at the end of 2003.

Kingdee was trading at $3.075 a year ago. The counter closed at $1.62 on Friday.



SMP Graphic Source: Bloomberg

Asian debt climbing credit ladder

Chris Oliver

They might seem expensive but emerging market bonds have life in them yet, according to one bond fund manager.

Raphael Kassin, head of emerging markets fixed income for ABN Amro, says it is not a good idea to dump bonds issued by emerging market economies such as Russia or Brazil at a time when they are better able to honour their debts, thanks to political and fiscal reforms in recent years.

The upward trend should continue this year despite high prices, owing to limited issuance and a growing appetite for risk.

"There is less supply and a hunger for yield," he says. "Demand will stay constant and might even go up. From that perspective it looks pretty good."

Spreads between emerging market debt and US Treasuries have narrowed to historic lows last seen shortly before the Asian financial crisis – a period of widespread optimism towards Asian credit. Unlike then, Asian debt now looks much healthier, with 45 per cent of the emerging market universe classed as "investment grade", compared with 20 per cent in 1997.

"It is a universe that is a lot better in terms of credit rating," Mr Kassin says.

He takes issue with the widely held view that the rally in global bonds is past its sell-by date. Turbulence in the debt markets in recent weeks, he says, was due to hedge funds seeking to shake out weak hands. He says he took the opportunity to buy on behalf of ABN Amro's Global Emerging Market Bond Fund.


Raphael Kassin

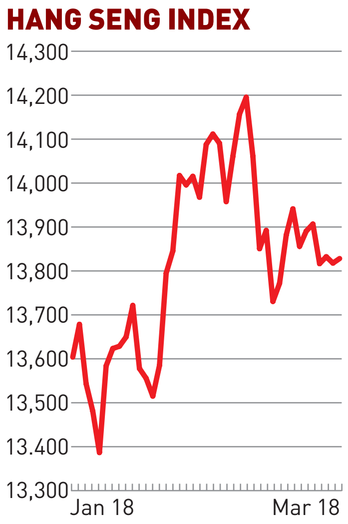
"Nothing has fundamentally changed," he says. "There has been a little bit of a panic on the US Treasury side, a bit of an overreaction."

He says fears US yields could spike suddenly are unfounded. In recent weeks, talk of the Federal Reserve strategy has shifted from a faster pace of rate rises to speculation it may not raise short-term interest rates at all. Under normal circumstances low US yields are good news for emerging market debt.

He estimates the bond fund will generate a return between 10 and 15 per cent this year, roughly half from coupon yield on underlying assets and half through trading gains.

"On a statistical basis, if you look at emerging market bonds in general, you see that they have a very nice return on risk levels that are lower than global equity," he says.

UPDATE



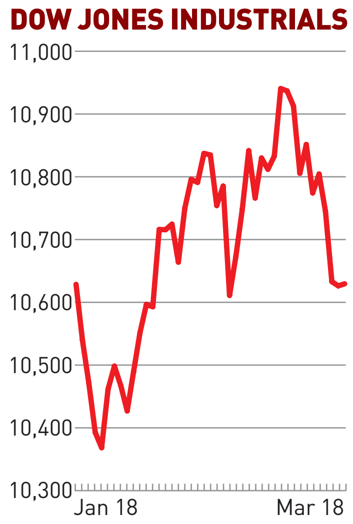
SMP Graphic Source: Bloomberg

Hong Kong shares are likely to move lower this week as concerns mount over higher interest rates and rocketing oil prices.

The United States Federal Reserve is expected to raise interest rates again when it holds its policy meeting on Tuesday. Hong Kong banks did not track the last several rate rises in the US but are widely expected to raise rates this time around by as much as half a point.

"The market won't be very good. Oil prices are rocketing and interest rates are likely to go up because Hong Kong banks lag so much behind," said Ben Kwong, head of research at KGI Asia.

For the week, the Hang Seng index fell 62.56 points or 0.45 per cent at 13,828.37. *AFP*



SMP Graphic Source: Bloomberg

The Federal Reserve's stance on interest-rate rises and the price of crude are set to call the shots in the market this week.

Higher oil prices could pull industrial and transport stocks lower, and rate fears could weigh on financial and homebuilders' shares, strategists said.

"What the Fed says will be on the minds of investors next week, as will be the cost of oil," said Alex Motola, portfolio manager at Thornburg Investment Management.

Crude oil futures closed at $56.72 on Friday. For the week, the Dow fell 1.34 per cent to 10,629.67, while the S&P 500 slipped 0.87 per cent to 1,189.65 and the Nasdaq dropped 1.66 per cent to 2,007.79. *Reuters*

EXCHANGE RATES

HK$	Bid	Ask
£	14.9869	14.9910
SFr	6.7023	6.7027
*¥	7.4438	7.4463
S$	4.7988	4.8002
A$	6.1985	6.2012
C$	6.4850	6.4854
Baht	0.2024	0.2026
NZ$	5.8052	5.8113
*Won	0.7759	0.7759
M$	2.0522	2.0525
NT$	0.2499	0.2508
Euro	10.3939	10.3949
Peso	0.1436	0.1439
Yuan	0.9423	0.9424

Rates yesterday *per 100 units Source: HKAB

Your Money welcomes your ideas and contributions. Just e-mail us at money@scmp.com