



Analyst

Barry M. Sine, CFA, CMT
646-422-1333
bsine@drexelhamilton.com

Technical Analysis

What's Really Going on With US Listed Chinese Equities?

- With a spate of recent fraud allegations, US listed Chinese stocks are some of the most toxic investments in the market today.
- But investing in out of favor sectors can yield the greatest rewards.
- Today's visit of incoming Chinese President Xi Jinping to the White House may bring a reset in US – China relations and spur renewed interest in Chinese equities.
- In this report we examine the major Chinese Indexes:
 - The Shanghai Stock Exchange bottomed in January and is 10% off its low
 - The Taiwan Stock Exchange bottomed in December and is 19% off its low
 - The Hang Seng Index bottomed in October and is 29% off its low
 - The USX China Index of US listed Chinese companies bottomed in October and is 25% off its low
- We also examine the 14 largest US listed Chinese stocks, those with market caps above \$5 billion:
 - China Mobile is the dominant stock at \$200 billion market cap and is at resistance of \$51
 - Next largest, at \$100 billion, energy company CNOOC has broken its downtrend, but on light volume
 - Taiwan Semiconductor broke old resistance just below \$14, with this level now serving as support
 - Google's China counterpart Baidu has formed a symmetrical triangle pattern with upside breakout likely
 - China Unicom has experienced multiple failed breakouts
 - PetroChina is unable to break above resistance at \$150
 - Taiwanese telecom provider Chunghwa Telecom is still trending down
 - China Life has also broken its downtrend
 - China Petroleum and Chemical is the best looking chart with a solid uptrend in place since August
 - China Telecom shares are still in a downtrend
 - Taiwan-based United Microelectronics broke its downtrend line on heavy volume, signaling conviction
 - NetEase is in a bullish ascending triangle pattern with a breakout to the upside expected
 - Melco Crown Entertainment, which is a Macau casino operator, has broken out on heavy volume
 - Yanzhou Coal has broken its downtrend but lacks conviction as volume is light

What's Really Going on With US Listed Chinese Stocks?

In this report, we analyze the technical position of every US listed Chinese stock with a market cap above \$5 billion. Of these, nine are based in mainland China, three in Taiwan and two in Hong Kong. By far the best looking chart is China Petroleum and Chemical while PetroChina shares are stuck at resistance. The worst stock, from a technical perspective is the telecom provider in Taiwan, Chunghwa Telecom.

From a value investing perspective, we believe that the best time to invest in a market sector is when sentiment is extremely biased against it. Presently, in our view, US listed Chinese stocks appear to be one of the most reviled investment sectors, and not without some cause. A series of frauds uncovered by diligent short-sellers, and halfhearted support in reforming fraudulent practices by Chinese regulators have undermined confidence in Chinese stocks. The most widely cited index of US listed Chinese stocks, the USX China Index, is off 42% from its October 2007 high but has more than doubled from its November 2008 low.

We believe that Chinese stocks, having fallen out of favor, will gain newfound interest by investors. Later today, Chinese Vice President Xi Jinping will be visiting the White House. Xi is expected to become the Premier or head of the government later this year and the media are expecting that this visit will lead to a “reset” of US-China relations. There are concerns about a slowdown in the Chinese economy as global commodities prices rise, real estate prices weaken and some manufacturing at the margin is returning to the US. But the Chinese economy is still largely tied to the financial health of its largest customer - the US consumer - who appears to be regaining his health after a long illness. So despite the concerns, there is a bull case to be made for the Chinese economy as well.

We do not have a view as to whether Chinese stocks now represent a good fundamental value or how pervasive the fraud issues are. However, the key premise of technical analysis is that the charts represent “the wisdom of the crowds” or, in other words, the many market participants ranging from savvy short-sellers like Muddy Waters, large sell-side and buy-side firms globally, individual investors and corporate insiders collectively bring all their knowledge to bear in the setting of share prices, and those with the most conviction, and presumably best knowledge, have the most impact on price given the higher volumes they trade. So, stock prices tend to correctly reflect underlying fundamental value. So in this report we look at what the technicals are saying about US listed Chinese stocks.

We begin with an overview of the major Chinese markets. Our focus is on mainland China, but it is impossible to analyze this market without considering the interrelated Hong Kong and Taiwan markets. The main stock exchange in China is the Shanghai Stock Exchange which trades two classes of stocks – A shares which are traded in Renimbi, and are limited to Chinese citizens and Qualified Foreign Institutional Investors, and B shares which are traded in dollars and available to global investors. The Shanghai Stock Exchange is 23% off its 52 week high and just 10% above its low having bottomed in January, so this may represent an interesting entry point for investors. In Hong Kong, the Hang Seng Index bottomed in September and has gained 29%. In Taiwan, the stock exchange is 19% off its high, having bottomed in December. The USX China Index of US listed Chinese stocks also bottomed in October and is up 25% off its low. So investors are seeing something they like again in Chinese stocks

Overall, most stocks are at inflection points of breaking out to the upside. A positive catalyst such as a good visit by Xi or a Greek settlement could push these stocks significantly higher. But, in our view, it is definitely time to be looking east again.

Fig 1. Major Chinese Indexes Breaking Out to the Upside, With US Listed Large Caps Beginning to Follow

<u>Ticker</u>	<u>Name</u>		<u>Last</u>	<u>52WH</u>	<u>Delta</u>	<u>52WL</u>	<u>Delta</u>	<u>Technical Commentary</u>
.SSEC	Shanghai Stock Exchange		2,351.98	3,067.46	-23.3%	2,132.63	10.3%	Bottomed in January
.TWII	Taiwan Stock Exchange		7,862.27	9,099.75	-13.6%	6,609.11	19.0%	Bottomed in December
.HSI	Hang Seng Index		20,783.86	24,468.60	-15.1%	16,170.30	28.5%	Bottomed in October
.HXC	USX China Index		5,132.79	6,691.00	-23.3%	4,111.29	24.8%	Bottomed in October
		Mkt. Cap.						
		\$ in bns.						
Mainland China Headquartered								
CHL	China Mobile	203.2	\$50.62	\$51.98	-2.6%	\$43.51	16.3%	Again at \$51 resistance
BIDU	Baidu	48.2	\$135.45	\$165.96	-18.4%	\$100.95	34.2%	Symmetrical triangle
CHU	China Unicom	43.5	\$18.47	\$22.50	-17.9%	\$15.30	20.7%	Multiple failed breakouts
PTR	PetroChina	32.0	\$151.72	\$158.83	-4.5%	\$111.29	36.3%	Also failing to break out
LFC	China Life Insurance	21.9	\$44.11	\$58.99	-25.2%	\$32.77	34.6%	Downtrend broken
SNP	China Petroleum & Chemical	20.2	\$120.39	\$125.36	-4.0%	\$82.50	45.9%	Solid uptrend
CHA	China Telecom	7.9	\$56.72	\$67.97	-16.6%	\$51.41	10.3%	Still in downtrend
NTES	NetEase.com	6.3	\$47.89	\$55.00	-12.9%	\$35.74	34.0%	Bullish ascending triangle
YZC	Yanzhou Coal Mining	5.0	\$25.57	\$41.89	-39.0%	\$17.49	46.2%	Downtrend broken
Taiwan Headquartered								
TSM	Taiwan Semiconductor	74.0	\$14.28	\$14.43	-1.0%	\$10.75	32.8%	Breakout above resistance
CHT	Chunghwa Telecom	24.9	\$32.06	\$37.46	-14.4%	\$28.94	10.8%	Downtrend still intact
UMC	United Microelectronics	7.0	\$2.69	\$3.18	-15.4%	\$1.77	52.0%	Breakout on heavy volume
Hong Kong Headquartered								
CEO	CNOOC Limited	100.8	\$225.68	\$271.94	-17.0%	\$141.27	59.8%	Downtrend broken
MPEL	Melco Crown Entertainment	6.5	\$11.82	\$16.15	-26.8%	\$6.46	83.0%	Breakout on increasing volume

Source: Company reports and Drexel Hamilton estimates

Fig 2. Shanghai Stock Exchange Bottomed in January and is Now Up 10%


Source: Metastock and Drexel Hamilton estimates

Fig 3. Shanghai A Shares, Traded in Renimbi by Locals Closely Tracked by B Shares, Traded by Foreigners, But Foreigners Panicked Over Greece in June, While Locals Did Not



Source: Metastock and Drexel Hamilton estimates

Fig 4. Taiwan Stock Exchange Broke Downtrend Earlier, in January



Source: Metastock and Drexel Hamilton estimates

Fig 5. Hang Seng Bottomed Much Earlier, Presaging Shanghai Rally



Fig 6. USX China Index of US Listed Chinese Equities Bottomed in October and Broke its Downtrend in January



Shares of Mainland Based Companies Near of Breaking Above Resistance

Fig 7. China Mobile Finding Resistance at \$51.50 – At \$200 bn Market Cap It Is Over 4x Larger Than Next Largest Co.



Fig 8. Baidu Shares Forming Symmetrical Triangle – Presaging Breakout to the Upside



Fig 9. Investors Still Bearish on China Unicom – Four Failed Breakouts in Ten Months

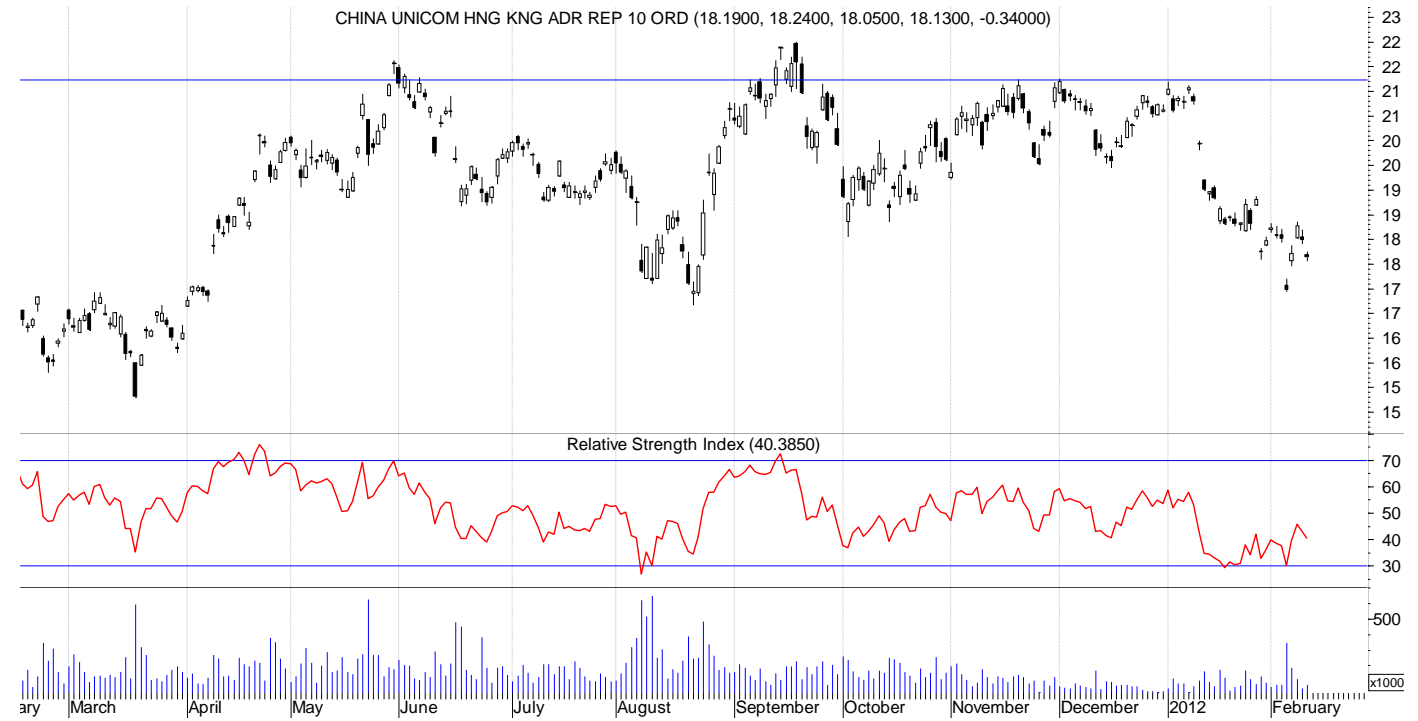


Fig 10. PetroChina Also Posting Multiple Failed Breakouts

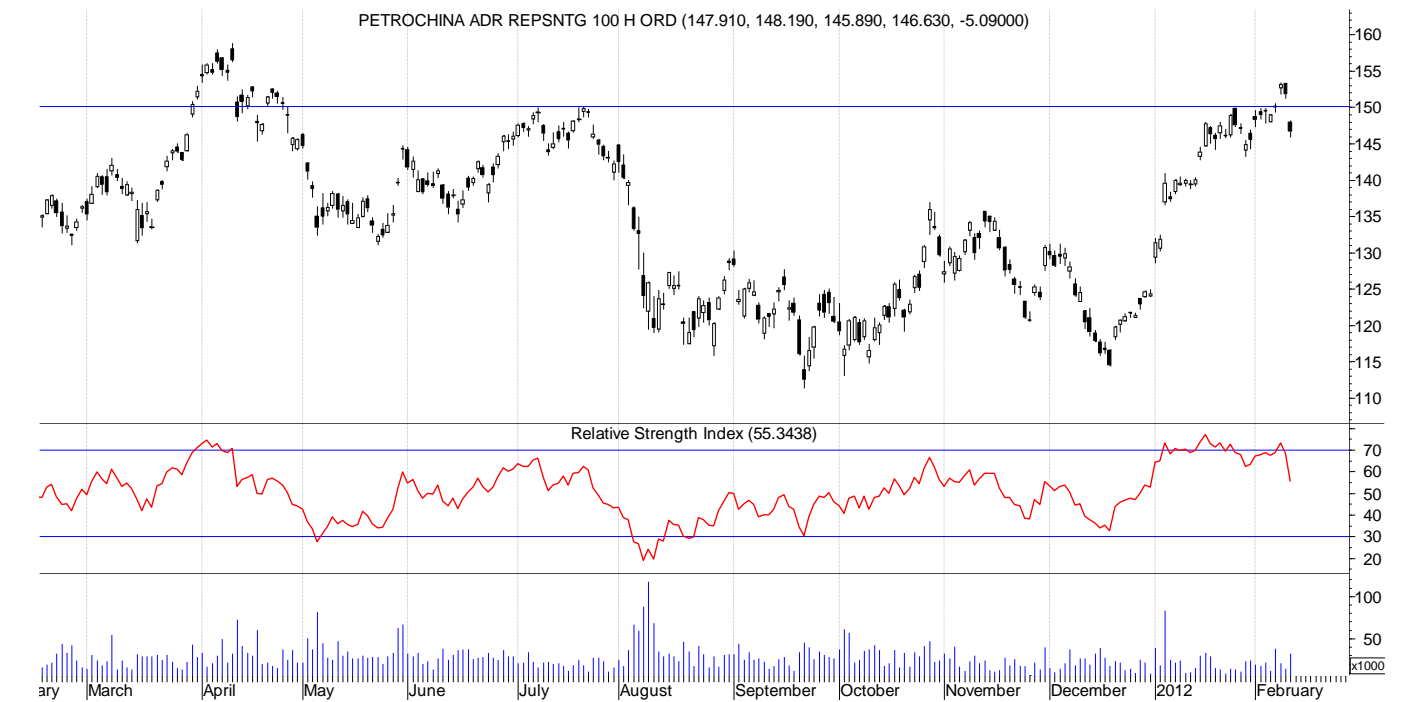


Fig 11. China Life Showing Signs of Life Breaking Downtrend – But Recent Momentum is Weak



Fig 12. China Petroleum and Chemical in a Solid Uptrend



Fig 13. China Telecom Still in a Downtrend



Source: Metastock and Drexel Hamilton estimates

Fig 14. NetEase Ascending Triangle Suggests Uptrend May Resume Soon



Source: Metastock and Drexel Hamilton estimates

Fig 15. Yanzhou Coal Has Broken Downtrend But Shows Little Conviction on Lagging Volume



Source: Metastock and Drexel Hamilton estimates

Taiwan Based Stocks a Mixed Bag

Fig 16. Taiwan Semiconductor Has Broken Old Resistance, Which is Now Acting as Support



Source: Metastock and Drexel Hamilton estimates

Fig 17. Taiwanese Telecom Provider Chunghwa Telecom Still in a Downtrend



Fig 18. United Microelectronics Have Broken Out to the Upside on Heavy Volume



Hong Kong Based Chinese Stocks

Fig 19. CNOOC Has Broken Out to the Upside, But on Light Volume



Source: Metastock and Drexel Hamilton estimates

Fig 20. Melco Crown Entertainment, a Macau Gaming Company, Has Broken its Downtrend With Increasing Volume



Source: Metastock and Drexel Hamilton estimates

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Company	Disclosure
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