

Cover Story

Magnifying your understanding of RMB-denominated assets

Investment Story

Domestic demand: the new thrust behind China's economic growth





Magnifying your understanding of RMB-denominated assets

China's economy is growing rapidly, and there are increasing expectations of RMB appreciation. However, the RMB is not yet a freely convertible currency, the Qualified Foreign Institutional Investor scheme (or QFII) is a specialised channel for Hong Kong investors to invest in RMB-denominated assets. Now there are many RMB-denominated investment products in the market, but not many really invest in A-Shares or RMB bonds. If Hong Kong investors want to capture the growth potential of the China market, investing in China A-Share and RMB bond markets through QFII is an ideal choice.

Investors with a positive outlook on the China market might like to become involved in H-Shares, red chips and China index funds, while some experts suggest that A-Shares have even higher investment value. Why?

Why invest in China A-Shares?

A-Shares	H-Shares or Red chips
<ul style="list-style-type: none"> • Around 1,750 companies listed in the A-Share market. • A wider spectrum of industry choices including financials, telecoms, energy and consumer stocks. So investors can fully capture opportunities from the growth of the mainland China economy. • Huge daily trading volume (approx. US\$16.6 billion) reflects the activity in the A-Share market. • CSI 300 Index was launched on April 8, 2005. Its 5-year performance reached 304%*, and outshone H-Shares by almost 100%. 	<ul style="list-style-type: none"> • No. of listed companies in H-Shares and red chips is relatively smaller, 253 in total at present. • The bias in the financial and telecommunications industries limits its representation of China's domestic demand-driven economy. • Daily trading volume is around US\$3.7 billion. • As of April 8, 2010, the H-Shares 5-year performance was 157%*, lagging behind A-Shares'.
<p>* Morningstar, all returns expressed in USD, as of April 8, 2010#. The CSI 300 Index's 1-year & 3-year returns were 35% & 27% respectively. # Five-year anniversary from the inception date of CSI 300 Index.</p>	<p>* Morningstar, all returns expressed in USD, as of April 8, 2010#. The H-Shares' 1-year & 3-year returns were 54% & 27% respectively. # Five-year anniversary from the inception date of CSI 300 Index.</p>

Why invest in China A-Share funds? Is there any difference from China index funds?

China A-Share funds	China index funds
<ul style="list-style-type: none"> Investing in the China A-Share market via the QFII scheme can give investors an opportunity to easily access the non opened-up A-Share market. Fund managers proactively manage their investment portfolios by carrying out stock selection and establishing investment strategies. Performance depends on the stock selection strategies from the fund managers, so there is a relatively higher chance to find stocks with growth potential besides the index constituent stocks. The performance could improve with the fund manager promptly adjust the investment strategy according to his intelligence of local economy swings and policy changes. Through the QFII scheme, the fund can invest directly in companies listed in the A-Share market, so investors can capture opportunities from these companies or industries. 	<ul style="list-style-type: none"> One of the Exchange Traded Funds (ETF) that trades on HKEx invests in a basket of securities, including derivative instruments linked to A-Shares and issued by a third party, which tracks index performance. Its principal objective is to track, replicate or correspond to the performance of an underlying index, and is thus known as a passive fund. Investment decisions are relatively passive as they simply follow the index which may miss some potential stocks, thus lowering the chance to outperform the index. For example, property and financial stocks have a relatively higher weighting in A-Shares. With recent policies to cool the overheating property market while encouraging domestic consumption by the mainland China government, A-Share index might be retrained by the performance of the property and financial stocks, and yet the potential of service and consumption stocks might be overlooked. Fund managers might adopt strategies like synthetic replication through the use of financial derivative instruments issued by a third party to replicate the index performance. Some China index funds do not invest directly in China A-Shares but instead gain access to the A-Share market by investing solely in China A-Share Access Products (CAAPs), including warrants and notes, which are derivative instruments linked to A-Shares issued by QFII. Investors, therefore, need to bear different levels of counterparty risk and structured product risk.

The development of China has led to expectancy about RMB appreciation, and so RMB-denominated products have recently become popular among investors. What are the differences between the RMB, RMB bonds and RMB bond funds?

How to choose between RMB bond funds and RMB?

RMB bond funds	RMB
<ul style="list-style-type: none"> Investing in RMB-denominated bond funds can benefit not only from the RMB appreciation potential, but also the interest rate, credit rating, maturity period and the supply of the bond fund which will affect the investment return. So there is not only just risk but also growth potential. The fund may gain additional return by not only reinvesting the distributed coupons to the fund but also by having the fund manager proactively manage the investment portfolio. 	<ul style="list-style-type: none"> Exchanging currency for RMB and depositing it with the bank will provide interest income. If the RMB appreciates against the original currency, profit can be realised from currency conversion. However, a potential loss may result from unfavourable exchange rate movement.

How to choose between RMB bond funds and RMB bonds ?

RMB bond funds	RMB bonds
<ul style="list-style-type: none"> An investment portfolio in which a fund manager can allocate investments in various categories of bonds and securities issued by different issuers that have different maturity dates, so as to diversify the investment risk. The fund may gain additional return by not only reinvesting the distributed coupons to the fund but also by having the fund manager proactively manage the investment portfolio. 	<ul style="list-style-type: none"> Investors only invest in the bonds of a single corporation or government, which belongs to a single item investment and therefore may be subject to greater concentration risks. RMB bond offers a fixed coupon rate which normally will not be affected by market volatility. Also, the capital will be fully returned to the investors upon maturity.

In conclusion, the RMB-denominated assets in mainland China will benefit from China's robust and vigorous economy in the long run, but investors should be aware that although there is a wide spectrum of choices for RMB-denominated products, only very few of them truly invest in A-Shares and RMB bonds. To capture potential capital gain in China's markets, investors are advised to look for funds that have acquired the QFII quota to invest in A-Shares and RMB bonds.

Domestic demand: the new thrust behind China's economic growth

The Chinese economy has undergone rapid growth in recent years, and the wealth of the general public has been increasing, thereby lifting their purchasing power. In addition, a population of 1.3 billion has brought a massive demand for local consumption, and the government has acted to stimulate domestic consumption with a view to replacing exports and investment as the new engine that drives economic growth. This scenario has helped the growth of domestic demand to become one of the leading themes in the China market.

An increase in wealth brings greater purchasing power

The financial crisis greatly changed the economic power of countries around the world: China has sustained rapid growth, while developed countries, such as Europe, the US and Japan, have been suffering from sluggish economic recoveries. In a prosperous economy, the general public amasses wealth rapidly. According to a *Financial Times* report, the number of Chinese millionaires (with assets of at least one million US dollars) has grown considerably to 477,000¹, and ranks in fourth place globally behind the US, Japan and Germany. The wealthy class has grown rapidly and, under the wealth effect, demand for goods, such as expensive real estate, automobiles and luxury goods, has grown enormously.

As well as some segments of the population getting rich, the manufacturing and service sectors have been hiring competitively, resulting in a temporary shortage of labourers in Guangdong. Quite a few factories have raised wages to keep their employees. For instance, Foxconn, a Taiwan-based manufacturer, recently announced that it would raise wages by a staggering 66%² for its Shenzhen assembly workers, with effect from October this year. Other manufacturers with factories in China have taken similar measures, and so the purchasing power of frontline workers has grown rapidly and has increased their demand for consumer goods.



¹ Financial Times (UK), June 22, 2010

² Asia Times, June 7, 2010

China is in great need of infrastructure and energy

China has a population of 1.3 billion. In the past, the majority lived in villages. Since the reforms and opening-up in the 1980s, there have been influxes of people moving from villages to cities where opportunities abound. For example, in 1975 the population of Beijing stood at 5 million, but an estimate has put the 2015 figure at 13 million. Shanghai had 5.6 million people in 1975, but there will be an estimated 17.8 million³ in 2015. An exponential rise in population means a huge demand for infrastructure, such as electricity, natural gas, water supply and transportation.



Because of the rapid growth in the economy, and in urbanisation and industrialisation, China's demand for energy has been on a perpetual rise. Data from the International Energy Agency shows that in 2009 China leapt to become the largest consumer of electricity in the world, overtaking the United States. In the past year, China consumed different energy sources equivalent to 2.25 billion barrels of oil, or 4%⁴ more than the United States. A decade ago, China's energy consumption was merely half that of the US. However, per capita, the average American's energy consumption was still five times that of the Chinese. At any rate, it can be seen that there will be strong demand for infrastructure and energy in the future.

Demand for health products ever increasing

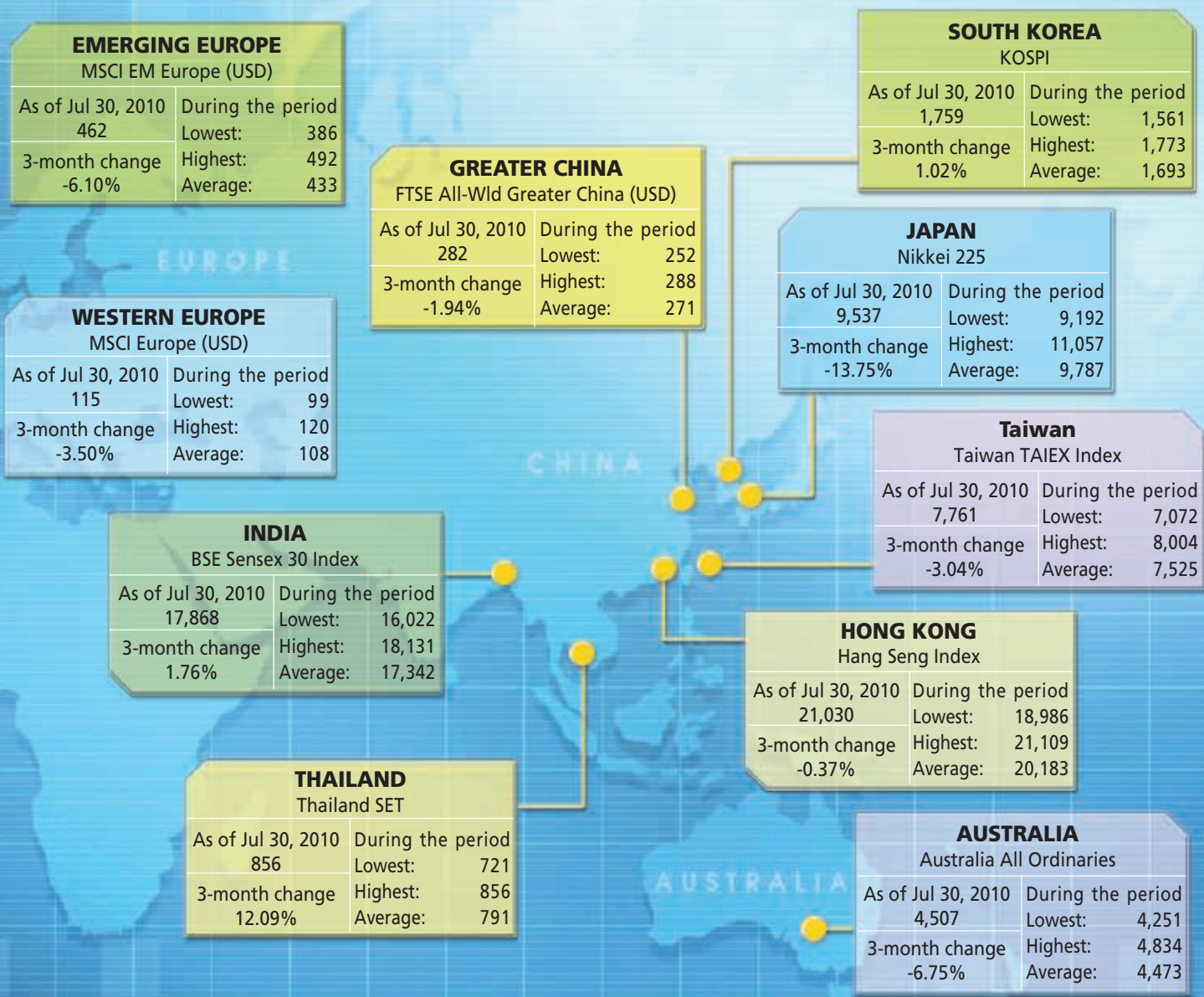


On a national level, a booming economy means a sizeable demand for infrastructure and energy. At the citizen level, rising incomes will stimulate consumption and improvement in the quality of life, and therefore nurture great potential for domestic-demand shares. Currently, medical care in China is still not as comprehensive as in Western countries. As the population slowly ages and personal finances gradually improve, the demand for medicine and health products is increasing. On top of that, the Chinese people have long been known to put great emphasis on health, and so the wealth effect indicates an increasing demand for health products and services.

In conclusion, the Chinese economy has been prospering, the income of the general public has been increasing, and the government has been keen on stimulating the domestic-demand market and therefore driving the overall economy to stable and continued growth. Also, savings rates of the Chinese people have long remained relatively high and debt levels low, so there is still great room to expand consumption. This has led to favourable reviews in the market towards the future potential of domestic-demand shares and relevant industries, and investors are advised to focus on the relevant investment opportunities.

³ United Nations, Department of Economic and Social Affairs, Population Division. World Urbanization Prospects: The 2009 Revision

⁴ Bloomberg, July 20, 2010



Source: Bloomberg

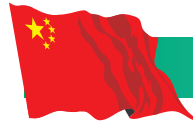
Index performance for the period of April 30, 2010 to July 30, 2010, price appreciation in local currency unless otherwise stated.

Bonds

- Government bond performance was modest during the period as rates in developed markets remained largely anchored due to diminished growth expectations.
- Strong fundamental and technical factors drove credit spreads tighter, resulting in a wave of well supported new issues and general outperformance of the sector.
- It is anticipated the recent rally in global rates to abate and for government yields to move higher over the medium term.

US Small Caps

- US stock markets rebounded in the month of July after a strong set of second quarter earnings reports from some of the world's biggest companies eased investors' concerns.
- The month was not without its negative moments in the US, where lower than expected GDP data and disappointing consumer confidence data impacted returns in the last days of the month.
- Many small-cap stocks are still selling at attractive valuations, given their earnings growth prospects and generous cash flow yields relative to bonds.



China

- Chinese equities performed well in July as policy clarity was improved in China after releasing the second-quarter GDP growth of 10.3% year-on-year, a slowdown from the first-quarter growth of 11.9%. This suggests tightening has had some traction and further tightening is less likely.
- Furthermore, interest-rate hike fears eased as inflation concerns remains in check.
- Regarding the cross-straits relations, China announced lifted restrictions on travel to Taiwan for residents from six areas in China: Gansu, Qinghai, Inner Mongolia, Tibet, Ningxia Hui and Xinjiang Uyghur.

UNITED STATES

S&P 500

As of Jul 30, 2010	During the period
1,102	Lowest: 1,023
3-month change	Highest: 1,202
-7.17%	Average: 1,097

LATIN AMERICA

MSCI EM Latin America (USD)

As of Jul 30, 2010	During the period
4,071	Lowest: 3,401
3-month change	Highest: 4,138
-1.63%	Average: 3,806



Korea

- Korean KOSPI equity index rallied 3.59% breaking the prolonged trading range and reached 1759 points in July (in terms of local currency).
- In terms of sector performance, China related sectors like materials and industrials, energy, financial sector performed well in KOSPI.
- The KOSPI's current valuation does not adequately reflect the recent string of record earnings, which have added to optimism that the index will rally in the waning months of the year.

Latin America

- Latin America equity market (MSCI Latin America 10/40) went up in July by 12.1%, over performing the Emerging Markets Free index (8.4%) and the MSCI World index (8.1%).
- Latin America equities had a strong return on July, as investor's risk appetite recovered during the month.
- A lower risk aversion triggered significant inflow to the region, favouring mostly the commodity and financial sectors. As a consequence, Brazil outperformed other countries given its higher exposure to commodities and a banking sector that was trading with discounted valuation to other Latin America banks.



Thailand

- The Stock Exchange of Thailand (SET) Index rose 7.3% in July.
- Ministry of Finance expects 8% GDP growth year-on-year in the second quarter of 2010 and forecasts the full-year 2010 GDP growth at 5.0-6.0%.
- External sector remained relatively untouched by the political troubles in May, with exports rising a solid 16%. July consumer price index was benign, rising 0.1% month-on-month, and 3.5% year-on-year.

Investment Tips

What are P/E and P/B?

The Price-Earnings ratio (P/E ratio) = market value per share / earnings per share.

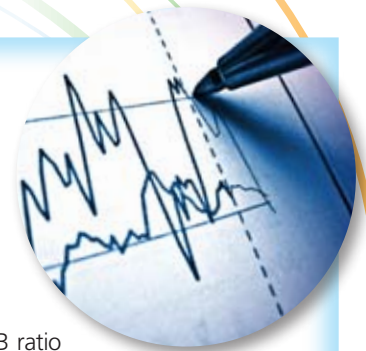
The P/E ratio can be interpreted as the time required for the shareholder to earn an amount equal to the investment. For example, if the P/E ratio is 10, it may require 10 years for the shareholder to earn an amount equal to his investment, provided that the P/E ratio remains unchanged.

The Price-Book ratio (P/B ratio) = price per share / book value per share.

The P/B ratio reflects the net value of the asset. Suppose that the company goes bust, the P/B ratio can be viewed as amount left for the shareholders after the debts have been cleared. If P/B ratio is less than 1, then the share price is undervalued.

The P/E ratio is used to assess the value of different equities. Its value is decided by the respective demand on the market; for example, the performance of the respective companies, the projection of the industry and potential development in the future. The P/E ratios vary from one country, or from one industry, to another, and may even be different at different times. Therefore, the P/E ratio is only a good reference for comparing shares of companies of the same kind, or for comparing the present and the history of a particular company. If one divides the share price by last year's earnings, the result obtained reflects the company's earnings in the past only. If the future value of the company is to be considered, then often the "estimated price to earnings" is used instead.

Regarding the P/B ratio, one can find the net value of the company in its annual or interim reports. Sometimes the estimated net asset in the future is used instead. This ratio is often used amongst banks for assessment, for the assets of banks include cash and loans, and their debts are deposits, which are market-independent.



Investment News

New Webcast on Show – China A-Share Market and RMB Bond Market

There's a new fund manager interview video now on the Manulife website! In the new video, Mr Matthew Lee, Mr Terrace Chum and Mr Ronald Chan from MFC Global Investment Management (Asia)* analyse the prospects of the China market and the growth potential of the China A-Share & RMB Bond markets, and shed light on why the opportunity to invest in these two sectors is NOW. To find out more, just click the promotion icon on "Wealth Management" on our website www.manulife.com.hk.

More webcasts will be coming soon, just stay tuned to our website!



* MFC Global Investment Management (Asia) is a division of Manulife Asset Management (Hong Kong) Limited.

Book Recommendation

《論性·中國篇—曹仁超創富智慧書》 ("Let's Talk About Personalities – China")

A veteran columnist for the Hong Kong Economic Journal, Cao Renchao has created the "trend investment" strategy by combining his knowledge and 30 years of valuable experience in investment. Today, he is one of the most popular financial columnists in Hong Kong.

Cao's latest book "Let's Talk About Personalities – China" contains his personal experience and 40 years of in-depth observation in the stock market, and illustrates the fact that personality is not only a key factor in life but also in investment.

In his book, Cao discusses people's weaknesses and common prejudices about investment. Personality plays a vital role in investment, and he believes that one has to fully understand oneself, understand one's strengths and weaknesses, and observe any ethnic weakness plus the differences between the two sexes, to achieve success in investment.

Author: Cao Renchao Publication: Enrich Publishing Publication Date: May 2010



Investments in the emerging markets may be subject to special risks and the risks could be substantially higher than the risks normally associated with the world's more established stock markets. Investment involves risks. Past performance figures shown are not indicative of future performance. Please refer to the prospectus for further details including the risk factors, charges and features of the product. Investor has his/her own personal investment objectives, investment products may not be suitable for everyone. Investors should not invest on the investment product solely based on this material. This material has not been reviewed by the Securities and Futures Commission (SFC).

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