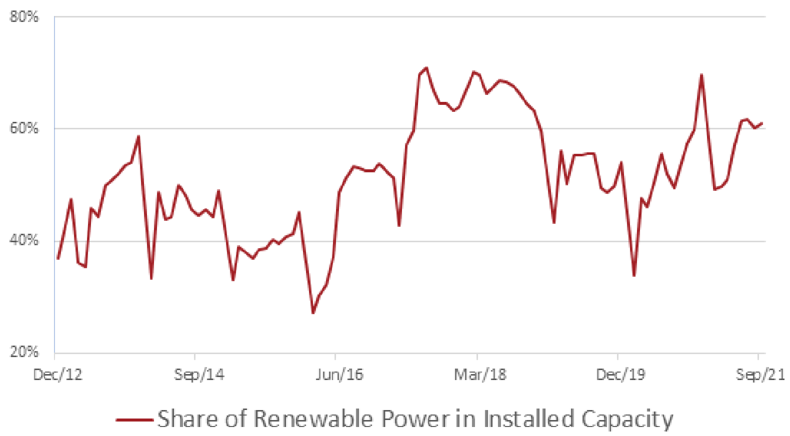
China Bulletin: Market View



The imbalance in the coal market is alleviating partially, as the inventory level of thermal power plants returns to a normal level from an alarmingly low level a month ago. While temporarily loosening its grip on fossil fuel energy, China remains determined to develop its renewable energy utilization capability. This is shown by the consistently dominant share of renewable power generation in installed capacity. The major obstacle to renewable energy is no longer the cost (after the significant efficiency improvements in the last decade), but rather the stability and reliability, which lacks a solution yet. However, recent turmoil in energy markets shows fossil fuel energy still plays a vital role in today's power system.

Headwinds facing China's property developers continue, though credit policy may ease marginally to make it easier to purchase a house. As for the property sector, policy makers have made clear that the foremost priority is to protect home buyers, and secondly to ensure vendors, as well as banks, can meet their liabilities, to avoid any drastic blow to the financial system. To complicate the issue further, property developers usually operate through project management companies in different cities to construct houses and receive sale proceeds. Local authorities have been granted the right to set up a custodian account in case troubled property developers fail to deliver houses to buyers and to meet the liability. We believe the crunch in the property market is still unfolding, and suggest avoiding exposure to the Chinese property sector for the time being.

In the past fortnight, China's equity market has been trending towards growth stocks and away from value names. Semiconductor and new energy supply chain names remain the market favourites, for their promising growth outlook. We have also seen the media and software sectors outperforming the market as the policy crackdown appears to be coming to an end, or at least a pause, and their valuation has largely priced in the shock. From a long term viewpoint, we believe the sector is worth holding. In other sectors, banks and insurers continue to slide due to the concern about property developers. To us the valuation of banks is too pessimistic as the largest, most profitable, and most systematically important banks are trading at 50-60% of their book value. We therefore remain positive on banks and believe their exposure to the property sector is manageable, especially for the largest banks.

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