Latest Market Analysis and Investment Strategy - June, 2015 Report

June Headline

New stocks board to help China's tech startups. A new board will be established at the Shanghai Stock Exchange to list tech companies as part of China's capital market reform to tend to the financing needs of small but innovative firms. China's securities regulators have also vowed to turn the country's approval-based IPO system into a registration-based one. Existing rules on companies seeking to list in domestic bourses have made profitability a pre-requisite for an IPO. This has barred many Chinese tech firms from listing in their home market and they have instead floated their shares overseas.

China approves 4 more QFII investors. China will allow four more overseas companies to move money into the country's capital account in May, as China is determined to speed up the yuan's convertibility. In the Qualified Foreign Institutional Investors (QFII) program, four companies including Brunei Investment Agency were added to the list, bringing the total number to 285. As of May 29, overseas institutions received QFII quotas amounting to $74.47 billion. The volume under the RQFII scheme totalled 382.7 billion yuan.

MSCI delay a catalyst for China's capital market reform. Stock-index compiler MSCI's decision to defer inclusion of Chinese mainland-listed A-shares in its global benchmarks could be a catalyst for further reform. MSCI said it "expects to include China A-shares" once "a few important remaining issues related to market accessibility have been resolved." MSCI identified three issues it would discuss with regulators -- quotas for large investors, capital mobility and details of beneficial ownership -- and is willing form a working group with the China Securities Regulatory Commission (CSRC) to address the concerns.

Economic Indicator Analysis

Inflation Rate

China's annual inflation rate was recorded at 1.2 percent in May of 2015, slowing from 1.5 percent increase in the previous month and slightly below market consensus. The politically sensitive food prices increased by 1.6 percent while non-food cost rose at a slower 1.0 percent. Among food, downward prices pressure came from: egg (-13.2 percent in May from -3.7 percent in April), fresh fruit (-3.2 percent from +1.5 percent), liquid milk and dairy products (-1.3 percent from -1.7 percent). In contrast, upward pressure came from cost of: fresh vegetables (+6.5 percent from +7.2 percent) and meat and poultry (+3.1 percent from +5.0 percent). Prices of pork also rose by 5.3 percent, following a 8.3 percent increase in the previous month.

Trade Surplus

China trade surplus increased to USD 59.49 billion in May of 2015 from USD 35.92 billion reported a year earlier. This is the third-biggest monthly surplus on record as imports declined more than exports. In May, exports dropped 2.5 percent year-on-year to USD 190.75 billion, compared to a 6.4 percent decrease in the previous month. Imports fell by 17.6 percent year-on-year to USD 131.26 billion as a result of declining commodity prices and following a 16.2 percent drop in April. In the previous month, the country registered a USD 34.13 billion trade surplus.

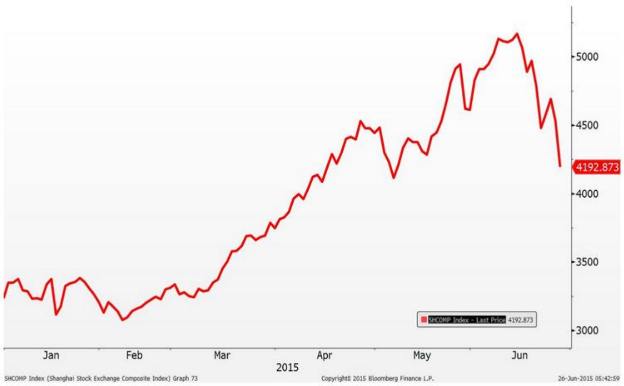
China Money Supply M2

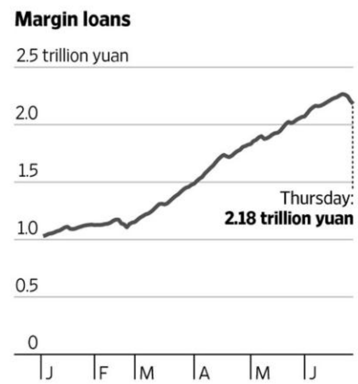
Money Supply M2 in China increased to 130740 CNY Billion in May of 2015 from 128080 CNY Billion in April of 2015. Money Supply M2 in China averaged 43072.22 CNY Billion from 1996 until 2015, reaching an all time high of 130740 CNY Billion in May of 2015 and a record low of 5840.10 CNY Billion in January of 1996. Money Supply M2 in China is reported by the People's Bank of China.

June Stock Market Performance Analysis

The benchmark Shanghai Composite Index closed at 4192.87, down 7.4 percent, while the Shenzhen Component Index slid 3.8 percent to 14398.79..

The Shanghai Composite Index fell 7.4% on June,27th and is off 19% since hitting a 52-week high on June 12, a decline that has wiped away $1.25 trillion in market capitalization, an amount roughly equal to the size of Mexico's economy.





Margin Financing

Margin debt, a favorite tool of speculators, has dropped for four straight days on the Shanghai Stock Exchange. The amount of margin trading has been attributed to the main risk for the current market condition. Margin loans have risen more than fivefold in the past year to 2.2 trillion yuan. This level is 4.6 times higher than what it was a year ago, equal to around 8.6% of the free float in the A-share market. This borrowing is equivalent to the value of 8.5% of China's tradable shares, double the ratio in Taiwan before its stock-market bubble burst in the late 1990s.

Despite the decline, the government has sought to stabilize the market earlier last week, proposing to remove the cap on commercial banks' loan-to-deposit ratios. At the same time, the central bank injected cash into the financial system already. However, after such a tremendous downward movement, the biggest difference is that this time the market regulator did not respond to the declines, which may further make investors worried about the market trend in the future.

Our Investment Strategies:

The market now has switched from irrational surge to irrational decline. As we mentioned above, the investors and market participants underestimated the consequence and impact of margin financing. It is the leverage that causes such much panic at this time. Meanwhile, the regulator has changed its attitude towards the decline as compared to their response to the most recent decline earlier. They are aware of the potential financial crisis so that they have to somehow control the pace of the market, especially in such a irrational market. Interest rate cut, reserve ratio cut. the change of the attitude towards margin trading and, most importantly, the entry of pension funds, annuity funds imply the importance of the capital market in China. It is rather safe to open position below 4000 point level where the panic would dry up. Thus, the structure of the market can change dramatically. Even though high valuation and high leverage companies may stop decline in the future, the rebound would be weak.

Therefore, we recommend:

1. Low P/E stocks (especially the ones may be backed the government, such as blue chips in the finance, real estate and Petrochemical sector.
2. Stocks whose largest shareholder has taken part in the non-public offering or the stock price is below equity incentive price.

Investment is the art of dealing with humanity. Psychology is more important than your investment strategy. The market would by no means follow our expectation but in the end we would get what we deserve.