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Latest market analysis and investment strategy

January Report

Macro analysis

1. **China Premier Li Keqiang tells Davos not to worry about China's slowing economic growth.** In a keynote speech at the World Economic Forum, he reassured the markets that his country will avoid much-feared "hard Landing" as economic growth slows and would not face systemic financial risks and the government aimed to improve the quality of growth to ensure an appropriate pace of expansion: The Chinese economy has entered a state of new normal. The gear of growth is shifting from high speed to medium-to-high speed, and development needs to move from low-to-medium level to medium-to-high level. This has made it all the more necessary for us to press ahead with structural reform. In the face of downward pressure, we did not resort to strong stimulus; instead, we vigorously pursued reforms, and the government in fact led these reforms by streamlining administration and delegating power. The goal of GPD growth rate for year 2015 is 7%.

2. **Shenzhen Stock exchange (SSE) aims to explore the possibility of second board/third board transfer.** SSE recently mentioned that it will emphasize on thesupervision reform of the stock market to boost the stock market performance, looking for the possible start of Shenzhen –Hongkong connect program later this year. The third board, commonly known as the small and medium sized enterprises share transfer system, has developed significantly since the expansion of service last year: the number of listed companies has grown by 340%; total market value and total number investors have increased by 730%and 500% respectively.

3. **The People's Bank of China, the central bank, announced that it has changed rules on how it calculates the loan-to-deposit ratios of banks.** The central bank expands the base for calculating loan-to-deposit ratios by including savings held by banks for non-deposit-taking financialinstitutions into bank deposits; the deposit reserve from customers are now included in bank deposits; the loans to financial leasing firms are now counted into bank loans. Under the current rules, Chinese banks are allowed to lend up to 75 percent of their deposits. By enlarging the scope of deposits, the central bank will defuse the pressure of attracting deposits on banks, especially medium-sized joint-equity commercial banks. It is estimated that the loan-to-deposit ratio may drop by more than 5 percentage points.

Market analysis

1) Under the circumstances that the global economy is slowing down and the demand for international market is sluggish, China economy is facing a downwardpressure. The growth rate for China's export and import volume in 2014 is only 2.3%, or 3.4% in US dollars, missing the goal of 7.5% set earlier. The Gross Domestic Product (GDP) in China expanded 7.30 percent in the fourth quarter of 2014 over the same quarter of the previous year. Full-year economic growth in 2014 reached 7.4 percent, undershooting the government's target of 7.5 percent and marking the weakest expansion in 24 years. The result might boost the structural reform by the local government to stabilize the economy and add more jobs to the market.
2) Consumption contributed 51.2 percent of the GDP growth last year, up 3 percentage points from a year earlier. Services made up 48.2 percent of the economy, up 1.3 percentage points. In the final month of 2014, industrial output and retail sales beat expectations. Industrial output increased 7.9 percent year-on-year, rising from 7.2 percent a month earlier. Retail sales grew 11.9 per cent, accelerating from 11.7 percent in November. Fixed asset investment, a key driver of the economy, grew only 15.7 percent in 2014.In spite of better than expected results at the end of 2014, more stimulus measures are widely expected in 2015 as deflationary pressure persists and the slowdown in the estate market is expected to continue.
3) Chinese banks issued 697.3 billion yuanworth of new loans in December, down from 852.7 billion yuan in November, data from the People's Bank of China showedThursday.Total social financing, a broader measurement of credit in the economy, rose to 1.69 trillion yuan in December from 1.15 trillion yuan in November.China's broadest measure of money supply, M2, was up 12.2% at the end of December compared with a year earlier, lower than the 12.3% rise at the end of November.China's foreign exchange reserves stood at $3.84 trillion at the end of December, down from $3.89 trillion at the end of September.

Dramatic Start of 2015

The start of 2015 was dramatic as the Shanghai Composite Index notched a massive loss of 7.7% on Jan.19th. The so-called Shanghai's "Black Monday" was widely blamed on regulators at the China Securities Regulatory Commission cracking down on brokerages that violated rules on margin trading. But the stock market recovered so fast that just in 4 days it reached a new recent high of 3406, only 70 points lower than the most recent high of 3478 in 2009. The latest progress of the fiscal reform points to further downside risk, which might continue to force policy makers to keep the stream of policy easingflowing.

China's central bank has extended the term of a due medium-term lending facility(MLF) valuing 269.5 billion yuan ($43.99 billion) and added another 50 billion yuan.On Jan 9, PBOC announced it will conti nue with prudent monetary policies in 2015 with bettercoordination of tight and loose monetary mea sures and proper fine-tuning.Given that cut in banks' required reserve ratio seems to be increasingly necessary, it would make china stock market increasingly attractive to the investors.

Our market expectation and strategy

Under the "new normal" circumstances, China needs to maintain its prudent monetary policy. Macro-economic policies should focus more on the job market, and keep the M2 growth rate stable. Blue-chip stocks still have potential to grow.We predicate that in the short term the market will continue to fluctuate. In the mid to long term, we remain confident that the market will continue to rally in 2015.

In terms of portfolio management, we recommend “buy low PB/price stocks” strategy for the current market situation:

1. Cheap stock with low PB will be benefited by revaluation and policy of stimulation and reform, for example financial, construction and resource.
2. Over-sold stocks during the recent market decline, with a steady growth or better than expected quarterly performance.
3. Sector-wise, we prefer the following sectors: Financial, Renewable Energy, Building, Natural Resources and Environmental Protection.